Capital Expenditure Controls in Local Government in England

A Report by the Audit Commission

April 1985

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Summary

In its second study carried under Section 27 of the *Local Government Finance Act of 1982,* the Audit Commission for Local Authorities in England and Wales (the Commission) has examined the effect on the economy, efficiency and effectiveness of local authorities of the present systems for controlling some £5 billion of annual capital expenditure in England. The study did not cover Wales, which has its own separate arrangements.

Local authorities' capital expenditure has declined by over 40% in real terms since the first oil crisis and the backlog of capital maintenance on local authority assets has been estimated at as much as £15 billion – though detailed survey information is lacking. Even so, the study reveals that the present systems do not achieve the level of annual control over local authority spending which the government would like and which is its primary objective.

In addition, the Commission believes that the systems have contributed to wasteful investment by a combination of delays to worthwhile projects, pressure to spend before the year end, failure to plan ahead and abrupt curbs in programmes with an associated loss of scale economies.

With the existing systems and on present public expenditure plans, local authorities will not be able to maintain, let alone improve, the state of existing local authority housing stock, schools and roads – the maintenance backlog could well be growing at the rate of some £1 billion a year. The effects of this decline will be more serious than they need have been. For many years, some authorities have been taking the 'soft' alternative to reducing waste and inefficiency, of capitalising maintenance expenditure and constraining maintenance budgets. As a result, capital programmes in these authorities are under greater pressure than would otherwise have been the case.

The Commission has concluded that a new approach is necessary. It would like to see the local authorities enabled and encouraged to do more to help themselves. They should be able to generate more funds internally without circumventing central government public expenditure controls. Three particular sources of additional funds for capital expenditure would be improvements in operating efficiency, increased charges for services and further sales of under-utilised assets.

But changes in the control systems will be needed if the potential new sources of funds are to be brought on stream. In devising new systems, the government will need to address the underlying causes of the present problems. In the Commission's view the main ones are:

(a) One year planning horizon. Local capital programmes need to be planned at least three years ahead if waste and inefficiency are to be avoided. Yet the present system provides firm block allocations of spending authority to individual councils for one year with only guaranteed minimums available for the next two years; and the proportions of capital receipts that can be used to fund increased spending have been changed at short notice. Moreover, government

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often intervenes at short notice, to encourage or 'damp down' anticipated spending.

(b) Limited scope for local initiatives. The present systems are designed to control expenditure levels; notwithstanding project controls, value for money is a secondary consideration. As part of the government's efforts to secure annual control over spending, local authorities must accept a large measure of central direction every year over the level of their capital programmes, priorities among services, the details of individual projects and how the programme will be funded. Inevitably this direction suffers from the usual problems (and hidden costs) of central planning and causes frustration locally.

(c) Insufficient incentives and flexibility. There is still scope for further asset sales – fewer than 10% of council houses have been sold, despite discounts of up to 60% on market prices. There is also worthwhile potential for funding capital expenditure from efficiency gains and increased charges for services. However, the present control systems do not allow local authorities to use these internal sources to fund an increased capital programme – there are currently over £5 billion of accumulated capital receipts, for example.

The current review of local government finance provides an opportunity to correct the underlying causes of the problems identified in the report that follows. The Commission would welcome the introduction of new systems which deal with the disadvantages of the present controls as it believes that the continuing rundown in local authorities capital assets disclosed by this study needs early correction.

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Glossary of Terms

Prescribed expenditure

Expenditure regarded as capital expenditure for the purposes of the 1980 Act. Covers nearly all expenditure on land and buildings of a permanent nature and grants and loans for similar purposes.

Non-prescribed

Expenditure defined by the Secretary of State in regulations as not being prescribed. At present these cover law and order services, most leased assets, a number of special payments of minor significance and de minimus expenditure.

Relationship of terms

Cash limit (net new borrowing)
+ non-prescribed proportion of capital receipts
− amounts unallocated and notional value of leased assets
= allocation (gross new borrowing)
+ prescribed proportion of capital receipts
= gross expenditure compatible with cash limit

Cash limit

The annual amount provided by the government for capital expenditure within the annual plan. It is intended that it should be the ceiling to the net increase in borrowing.

Non-prescribed proportion of capital receipts

The proportion of a capital receipt which cannot be used to support additional expenditure. Because it has to be invested and therefore nets down borrowing the government adds a proportion to the cash limit to provide a sum which local authorities may borrow.

Allocation

The limit to the amount which an authority can borrow after deducting any capital grants from central government or the EEC which have then been used to finance prescribed expenditure.

Prescribed proportion of capital receipts

The proportion of a capital receipt that can be used in any one year to supplement allocations. Currently 20% for most housing and 30% for non-housing receipts.

Gross expenditure compatible with cash limit

Allocations plus the prescribed proportion of capital receipts arising in the year plus amounts held back to allow for the use of accumulated receipts.

Net new borrowing

The maximum permitted is assumed to be the total of allocations less the non-prescribed proportion of current capital receipts which, because they cannot be used to support spending, must either be invested or used to repay debt – and therefore net down the gross borrowing attached to allocations. In practice, some allocations will lapse or be funded from other sources.

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Over or underspend	The difference between what local authorities actually spend and the gross expenditure compatible with cash limit.
The "cascade" principle	The prescribed proportion of capital receipts is calculated annually. Thus, if in the case of a prescribed proportion of 50% an authority applies that percentage in year 1, it may then apply a further 50% of what remains in any following year; and so on.
Notional capital receipts	Capital receipts which create spending power but are not backed by cash. Basically these arise in two ways: where the cash is used to repay debt, the notional value of the receipt can still be used to authorise capital expenditure; or from the disposal of certain leasehold interests.
Tolerance	A fixed percentage (currently 10%) which local authorities are allowed to spend over their allocations. It was the intention that this tolerance must be justified either from unused allocations from the previous year or by anticipation from the following year. This rule is only brought into play where an authority's prescribed expenditure exceeds its allocations and the prescribed proportion of its capital receipts. Practically, this means that most authorities have been able to use their tolerance without affecting next year's allocation.
Virement	The transfer of allocations between two or more of the six allocation blocks used by government e.g. from education to housing or between authorities.
Enhancement	Primarily the prescribed proportions of housing, non-housing and notional capital receipts, lotteries, trading profits and the agreed tolerance.

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Introduction

1. The Audit Commission for Local Authorities in England and Wales (the Commission) is required, under Section 27 of the *Local Government Finance Act, 1982* to undertake or promote studies designed to "enable it to prepare reports as to the impact of the operations of any particular statutory provision or provisions or of any directions or guidance given by a Minister of the Crown . . . on economy, efficiency and effectiveness in the provision of local authority services or on their financial management".

2. Accordingly, last August, the Commission published a report on *The Impact on Local Authorities' Economy, Efficiency and Effectiveness of the Block Grant Distribution System.* That report was concerned with the way in which some £8.6 billion of grant in aid is distributed to local authorities; and it drew attention to the need for major changes in the present system.

3. Over the last six months, the Commission has been examining the systems by which central government seeks to control local authorities' capital expenditure which now amounts to some £5 billion a year, around 12–13% of authorities' total annual expenditure. The study does not consider law and order services (police, magistrates' courts, probationary services) as they are controlled separately by the Home Office; and because of differences in regulations and administration that apply to Wales the study was confined to England. Once again, as the Act requires, the Commission is concerned to evaluate the effect of the system on local authorities' economy, efficiency and effectiveness. In particular, this report considers the extent to which the present systems for controlling capital expenditure are consistent with what the Commission believes to be the basic requirements for sound management set out in its earlier report on the block grant arrangements:

(a) *Delegation of authority and responsibility as far down the line as possible and effective local accountability.* This principle of management lies at the heart of successful businesses. The Financial Management Initiative launched by the government to improve management within the Civil Service also lays great (and the Commission believes appropriate) stress on its application in the public sector at large.

(b) *Longer term strategic perspective.* Any well run organisation requires a reasonable medium term planning horizon if it is to make effective, economic and efficient use of the resources at its disposal. This is especially true when capital projects are in prospect.

(c) *Positive incentives and encouragement.* Organisations as well as individuals require positive incentives and encouragement as well as sanctions. At the very least, it is important to ensure that control systems do not provide perverse incentives – that is, that they do not penalise authorities taking sensible steps and that they do not apparently reward those failing to take appropriate action.

(d) *Flexibility.* Priorities change and urgent problems affecting individual authorities arise which could not reasonably be anticipated. Any system for controlling local authorities' capital expenditure

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must be sufficiently flexible to allow promotion of new policies and initiatives and to react to the unexpected.

4. The systems for controlling capital expenditure differ in important respects from those designed to control revenue expenditure and distribute grant in aid. Central government is not so much seeking to support ratepayers and influence expenditure patterns by distribution of grant of Exchequer funds voted by Parliament; rather it is trying to control the level and distribution of funds raised by local authorities. Table 1 below shows the amount and source of local authorities' capital expenditure finance in 1983–84.

Table 1: AMOUNT AND SOURCE OF CAPITAL EXPENDITURE
£billion, 1983–84 (England only)

Total payments	
Fixed assets	£4.19 bn
Grants and advances	1.21
Capital value of leased assets	.15
	5.55
Sources of funds	
Allocations [of new borrowing ceiling]	4.30
Capital receipts	1.10
Other	.15
	5.55

Source: Capital Expenditure and Debt Financing Statistics. CIPFA 1983–84.

Thus, unlike the block grant system where taxpayers' money is being distributed to local authorities, in this case central government is seeking to control expenditure that is initially funded by local authorities but which may eventually attract general or specific grants on some of the debt servicing charges.

5. A new system for controlling capital expenditure was introduced in the *Local Government Planning and Land Act, 1980.* The new system replaced arrangements for controlling additional borrowing by making capital expenditure allocations to authorities – which could be enhanced by (a prescribed proportion of) their capital receipts. The present system is described in Appendix A. It has been in operation for almost four years; and over the same period, authorities have been selling off assets, notably council houses, at the rate of over £2 billion a year – about seven times the earlier level. This seems a good moment to review the system's effectiveness in achieving its stated objectives.

6. The new system for controlling capital expenditure does not seem to have been conspicuously successful either from local authorities' or government's point of view. The first two years of the new system saw an underspending against the relevant cash limits of £1.4 billion, or over 20%; but expenditure in 1983–84 was some 15% above the cash limits; and the outturn for the present financial year could be as much as 30% or more above the cash limits – thus, according to the Secretary of State, threatening the government's financial strategy. At the same time, many commentators as well as a number of local authorities consider current levels of capital investment in roads and schools and renovation of council houses in particular to be inadequate. As a result, radical changes to the system are under consideration.

7. The Commission takes the view that controls over local authorities' revenue and capital expenditure should not be considered in isolation one from the other. As Exhibit 1 shows, local government's revenue spending since reorganisation has risen in real terms in spite of the fall in central government grant. In contrast, capital spending has declined sharply. A

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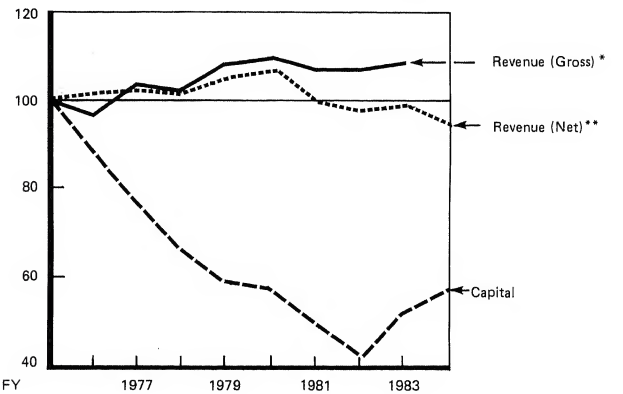
general response to pressure on revenue budgets has been to limit maintenance expenditure on such assets as schools, houses and roads. This trend ultimately leads to the need for major renovations which are financed on the capital account – and which thus compete with the "normal" capital requirements necessary to meet changing needs and demands (e.g. alterations to schools to meet falling school rolls, improving facilities in residential homes for the elderly, provision of sheltered housing and leisure facilities). This report therefore deals with steps necessary to arrest the rundown in capital assets. It also suggests the need for changes to the present control systems if inroads are to be made into the capital expenditure backlog that has built up over the past decade.

Exhibit 1

TRENDS IN LOCAL AUTHORITIES' SPENDING FY 1975-1984
1980 Prices; Index: FY 1975 = 100



* As at end February 1985, reliable information on authorities gross revenue expenditure for the year to end March 1984 was not available

** Net grant and rate-borne expenditure

Source: Analysis of Local Government Financial Statistics (see Appendix D)
Annual Abstract of Statistics

8. The Commission has adopted the same basic approach to this study as it used in examining the block grant system. A team was established under the Commission's Director of Special Studies, including two officers from CIPFA Services Ltd. They have analysed the available centrally held information as well as the results of a brief questionnaire completed by over 180 chief executives. A cross-section of 20 local authorities was studied in more detail. An issue analysis was developed in consultation with the local authorities' associations, relevant government departments, CIPFA and the Society of Local Authority Chief Executives (SOLACE). From this, a detailed questionnaire was prepared, tested and sent to each of the 20 authorities for completion. Each authority was then visited and the completed questionnaire used as an agenda in order to give consistency to the interviews. Appendix B summarizes the findings of the fieldwork. Following completion of the fieldwork, meetings were held with the

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Departments of the Environment, Education and Science, Transport and Health and Social Security, as well as with the Scottish Office, and H M Treasury and the local authority associations. Follow-up meetings were also arranged with four further authorities in order to clarify certain points on project control in education and housing. The Department of the Environment has provided summaries of centrally held data as required. In parallel with these efforts, senior officers of the Commission have taken opportunities of discussions with members and senior officers within local authorities to explore the issues involved.

9. The Commission is very grateful for the help that it has received in carrying out this study, both from local government and officials within central departments. But it alone is responsible for the three main conclusions set out in this report:

(i) *The present system of controlling capital expenditure is causing serious problems*, which will not be solved by introducing yet tighter controls. The present system itself is causing waste and inefficiency in authorities not equipped to cope with abrupt changes in capital expenditure levels; and it is failing to provide controls adequate to government's needs. The serious nature of the problems is masked, to some extent at least, by sales of assets which are unlikely to be maintained at current levels particularly if the incentive to generate them continues to be reduced. Chapter 1 describes the problems and the evidence for the Commission's belief that they are serious and need to be addressed.

(ii) *An important cause of these problems is the failure to put the principles of sound management into practice:* mutually inconsistent objectives leading to unnecessary complexity; limited local flexibility; too short a planning horizon; inappropriate, even perverse, incentives; and inadequate information. Chapter 2 summarises the Commission's views on the underlying causes of the observed problems.

(iii) *A new approach is necessary.* Continuing to reduce capital spending because of the failure to control revenue expenditure is, at best, short-sighted. Chapter 3 suggests the outlines of a fresh approach, in the hope that this will be useful and timely as government considers how the present system should be changed.

The Commission is, of course, independent of central and local government. It is no part of the Commission's duty to challenge government policy – any more than the Commission's auditors may question an authority's policy in the exercise of its statutory responsibilities. It follows that this report does not comment on, still less question, the present government's macro-economic policy objectives or service priorities. Rather, as the Act that established the Commission requires, the report is concerned with the impact of these policies on local economy, efficiency and effectiveness.

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1 The problems resulting from the present control systems

10. As described in Appendix A, with effect from April 1, 1981 a new system for controlling local authorities' capital expenditure was introduced. In late December or early January every year, each authority receives a capital expenditure allocation for the year beginning the following April, in separate blocks: education, personal social services, transport (roads, public transport, ports and airports), housing, urban programme and "other services". The allocations to authorities are made by the relevant central departments. Exhibit 2 shows the breakdown of expenditure by service (allocation plus use of capital receipts) and illustrates the importance of housing, roads and education which between them account for almost 75% of expenditure. Departments also retain some measure of control over individual projects. For example:

- All local authorities road schemes costing over £1 million accepted for Transport Supplementary Grant (TSG) are "named" by the Department of Transport, and progress of each project is monitored centrally. £1 million would pay for approximately 3km of single carriageway road in virgin ground.
- Certain particulars of all LEA building projects costing £120,000 or over must be submitted individually for the approval of the Secretary of State for Education and Science; and those not meeting DES cost guidelines are considered on their merits by the department from the point of view of value for money. (This is a separate statutory process from that under which proposals to establish, close or significantly change a school have to be advertised locally and may require the Secretary of State's approval).
- All housing authorities receiving general housing subsidy (79 authorities, accounting for 32% of council houses in 1984–85) are obliged to submit nearly all capital schemes to DOE for approval; and most municipalisation and land acquisition schemes require the Secretary of State's approval. Details of all housing improvement projects, however small, are provided to DOE at the design, tender and practical completion stages.
- In Partnership Authorities within the Urban Programme, a local committee chaired by a DOE Minister is established to develop a programme of works for approval. Programme and other designated authorities are also required to seek approval for individual projects.
- Allocations are sometimes made direct to authorities for specified projects of national importance e.g. the Thames barrier, and for special services e.g. sea defences and transport allocations in respect of airport spending.

11. These allocations can be "enhanced" by a proportion of the local authorities' net capital receipts, profits from trading undertakings, tolerance and non-prescribed expenditure. In the case of receipts from the sale of council houses, the 1983 regulations provided that 50% of receipts from

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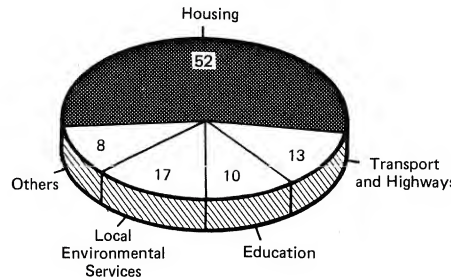
sales or repayments could be added to capital allocations for the year, with a further 50% of the balance available in the following year, and so on. The 1984 regulations reduced the prescribed proportion (as it is known) of receipts to 40%. And in late 1984 the Secretary of State announced proposals for a further reduction in the prescribed proportion for 1985–86, to 20%. The proportion of non-housing receipts available has also been changed frequently. Starting at 100% in 1981–82, it was 50% in 1984–85 and is now 30%.

Exhibit 2

BREAKDOWN OF LA CAPITAL EXPENDITURE – 1984

%



Source: Local Government Financial Statistics (see Appendix D)

12. Authorities can reallocate their total capital allocations (apart from those referred to above) as they see fit, to reflect local priorities; but they have been reluctant to use this power, fearing it might contradict Departmental policies and result in lower allocations in future years. Up to 10% of an unspent allocation can be carried forward to the following year and authorities can also transfer allocations between them.

13. Each local authority thus has what might be termed capital expenditure capacity for a given year made up as shown in Table 2 below, for one of the authorities studied during fieldwork for this study.

Table 2: CAPITAL EXPENDITURE "CAPACITY" IN A METROPOLITAN DISTRICT, £million, 1983–84

Department allocations		
– transport	£0.2 m	
– education	1.4	
– housing	14.4	
– social services	.7	
– others	1.3	18.0
Net effect of transferred allocations		–
Net capital receipts		
– carried forward from prior years	16.0	
– 1984–85 receipts (est)	5.4	21.4
Profit of trading undertakings		.2
Tolerance		1.4
Non-prescribed expenditure		.9
TOTAL CAPACITY		£41.9

14. This study has revealed some serious problems with this system, in terms of its effect on local economy, efficiency and effectiveness:

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(i) Expenditure is not under control from the government's point of view. And there remains pressure to spend before the year end.
(ii) Inefficiency results within local authorities: waste, delays in undertaking projects, rushed appraisals of projects and continued under-utilisation of assets are all to some extent attributable to weaknesses in the system.
(iii) Capital assets are being rundown. More investment, most notably in housing renovation, schools and roads appears necessary to compensate for authorities' failure to maintain their capital assets in the past.

This chapter discusses each of these problems in turn.

LACK OF CONTROL

15. As Ministers have repeatedly made clear, the government's overall priority in setting up the new capital expenditure control system has been to contain the total of local authority net capital expenditure and related net borrowing within the overall cash limit provided in the relevant public expenditure plan. As Table 3 below (which excludes law and order services) indicates, capital expenditure has varied considerably from the planned cash limits in each of the four years since the new system was introduced – even though, cumulatively, expenditure to the end of the present financial year seems likely to have been close to the total of the cash limits for the four year period and no authority has spent more than is allowed under the existing control systems:

Table 3: LOCAL AUTHORITIES' NET CAPITAL EXPENDITURE
Variance from government cash limits

	£million	% cash limit
FY 1982*	− 529	16.8
1983	− 870	25.7
1984	+ 368	12.5
1985 (Estimate)	+ c.800**	29.4
TOTAL	− 231	1.9

* Throughout this report, financial year refers to the year ending March 31, i.e. FY 1982 is the twelve months ending March 31, 1982.

** The latest DOE estimate (at February 19, 1985) is £650 million; but indications available to the Commission suggest that the variance will be higher.

Because the government's financial planning is on an annual basis government is seeking conformity with annual cash limits. So a respectable performance over four years is not good enough, from the standpoint of the government's economic strategy.

16. The lack of control over annual capital spending has been exacerbated by the success of the government's policy of encouraging authorities to sell council houses and under-utilised assets and partly from short-term government initiatives. These are discussed separately below.

Asset Sales

17. The Right to Buy legislation means that even with the restrictions on the proportion of receipts they are allowed to use for capital expenditure, local authorities have been able to increase their allocations by large amounts from the sale of council houses. The scale of the potential enhancements can be appreciated from Table 4 below.

Table 4: CAPITAL EXPENDITURE, ALLOCATIONS AND RECEIPTS, £million

	FY 1982	FY 1983	FY 1984
Expenditure	£3917 m	4750	5547
Allocations	3493	4215	4038
Receipts	1411	2235	2224
[Receipts as % of allocations	40.4%	53.0	55.1]

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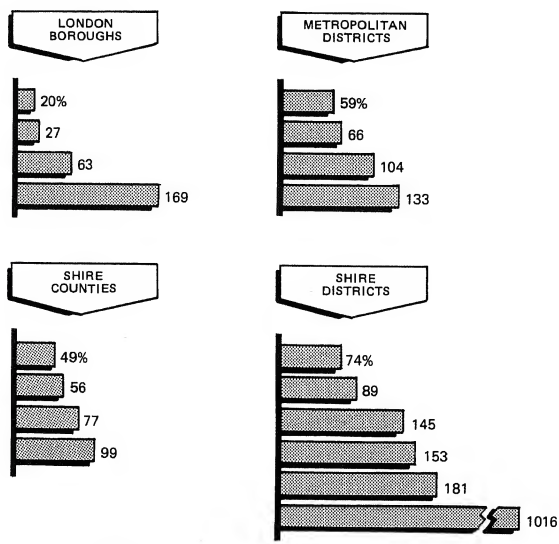
However, these receipts do not give a reliable indication of the scope local authorities have to enhance their allocations. They only show receipts for a given year; and receipts in hand at the beginning of the year are also available. Furthermore, as explained in Appendix A, DOE circular 6/84 specifies that tolerance is generally available as an addition without future penalty, providing sufficient prescribed capital receipts are in hand. In order to test the full scope for enhancement (including non-prescribed expenditure), the fieldwork questionnaire and interviews asked 20 local authorities to provide full details of their spending power and actual spending in each year. The results are included in Appendix B. Exhibit 3 shows the extent to which the various authorities surveyed were able to enhance their capital allocations from year to year. It also illustrates one of the technical difficulties facing government: the present control system involves forecasts of annual capital receipts; but these are notoriously difficult to assess in advance, because of the many complexities involved in selling that are outside the control of local authorities.

Exhibit 3

Enhancement capacity varies among authorities

ENHANCEMENT IN FIELDWORK AUTHORITIES – FY 1984

% of Capital Allocations



Source: Study Team analysis of information in Fieldwork Authorities

18. Government can only secure the close control over annual capital expenditure that it seeks by limiting the scope for enhancement. But this reduces the incentive for authorities to sell off under-utilised assets – where the benefits of lower interest charges do not seem sufficient to compensate for the loss of the use of the property. Moreover if enhancements are not available, capital expenditure will fall even further than was shown in

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Exhibit 1, unless allocations are increased – which will of course have a potentially adverse effect on public sector borrowing.

19. Because of the obvious difficulties involved in matching project expenditures with financial years and in view of the problems in forecasting capital receipts referred to above, most authorities are cautious in committing the use of new capital receipts. They tend to rely on receipts in hand from previous years. This has been particularly true in the period under review because of the dramatic increase in receipts from the sale of council houses. Most housing authorities wished to gain experience from selling large numbers of houses during 1981 and 1982 before committing additional expenditure. Furthermore, many authorities regard it as prudent to save up receipts for a large project in order to be confident of being able to carry it through to completion – in 1983–84, the 20 fieldwork authorities had over 80 separate projects involving at least 36 months of capital payments. Perhaps, at this point, it should be emphasized that no individual authority has overspent its allocations; rather the amount of past receipts that were used by authorities to support new capital expenditure was greater than anticipated.

20. This sensible approach by authorities has allowed them to use the prescribed proportion of receipts in hand as well as those arising currently. Furthermore, the "cascade" principle means that practically all the capital receipts have eventually been available for supporting new expenditure. Thus, for example a 50% proportion becomes 93¾% in four years and continues to increase albeit slowly after that. The cash limit calculation does not take direct account of these factors.

Government's Initiatives

21. Local authorities' spending patterns are often affected by government initiatives. For instance, the overspending in 1983–84 was partly due to the government's decision to stimulate expenditure on improvement grants. Spending above an "indicative figure" within an authority's Housing Investment Programme and in excess of the total allocation, automatically qualified for an additional allocation. Approximately £500 million was allocated in this way. However, although the government granted these additional allocations it did not raise the cash limit. The government claimed it had only intended to encourage spending up to the cash limit and not over it – although an individual authority cannot be expected to assess the effect of its actions on the national cash limit.

22. The government's desire for annual control over capital spending has led to two specific initiatives both of which have militated against economy, efficiency and effectiveness: the encouragement to spend in late 1982 because of the large underspending anticipated at that time for 1982–83, and the recent call for voluntary restraint.

Encouragement to spend in late 1982

23. In practice, because of the nature of capital expenditure and the long lead-time required for implementation*, large additional allocations late in a financial year can rarely be used efficiently. The fieldwork questionnaire and interviews asked twenty local authorities how this additional spending power had been used. The replies were as follows:

- seven authorities had not done any additional work; they saved capital receipts or converted deferred purchase arrangements;
- seven authorities had sought and been given additional resources

* For example, the lead-time before construction can begin on a £500,000 sheltered housing project is around 22 months; even for an "enveloping" scheme for modernising 30 council houses, it might take 14 months to carry out the preliminary work, let the contract and move the tenants to alternative accommodation.

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to introduce non-programmed, lower-priority work because of easy implementation; and
- one authority had paid the whole of its additional allocation of about £15 million to a company it created in order to beat the time limit.

One large local authority which is not untypical received an initial allocation of £40 million, during the period November 26, 1982 to January 11, 1983. On request, further allocations of £30 million were granted for that year only, together with another £8 million transferred from another local authority. This additional £38 million had be be spent by March 31 or lost forever. Apart from enabling the authority to save capital receipts, more than £12 million of this allocation was spent on normal repairs and maintenance and one-third of its vehicle fleet was replaced. Officers within the authority admitted to accepting prices significantly higher than lowest tenders* and accepting schedules of rates up to 90% above normal levels. Such reactions are inevitable when large sums are made available and have to be spent at short notice. As it was put to the study team: "We had this money to get rid of by March. The priority was can you do it in time?" Although the Commission cannot condone such disregard for value for money, these attitudes are the understandable side effect of short term pressures to spend – particularly where detailed contingency plans are not in place.

Call for voluntary restraint in late 1984

24. A second and more recent initiative has been the announcement in July 1984 asking local authorities to curb spending plans because of the scale of the threatened over-spending and the announcement in December that year of the proposed reduction in prescribed proportion of capital receipts for 1985–86 to 20% and 30% for housing and non-housing receipts respectively. This approach could have had the opposite of the effect desired. The government's intentions were signalled in sufficient time for many authorities to take advance defensive action; and the letter introduced new criteria into the control system. The threat posed to capital receipts arising in earlier years and the inclusion of non-prescribed expenditure within the curb has undermined local authorities' confidence in the present system and may have encouraged action to protect the next year's (uncertain) position. In these circumstances the reaction of local authorities may well have been to commit their accumulated capital receipts to expenditure whilst this was still legal.

25. A sample of returns from local authorities suggests that many have indeed ignored the call for restraint. Discussions with local authority associations and the nature of financing arrangements negotiated by authorities with City institutions support this view. It has also been reported to the Commission that some authorities that had originally intended to comply with the call for voluntary restraint, on the understanding that they would have been allowed to carry out a "reasonable" level of expenditure next year, reconsidered their position in view of the reduction in prescribed percentages and housing allocations. As one shire district treasurer expressed it: "the proposed rules for 1985–86 will reduce this authority's capital spending capacity by £800,000. We are to be "rewarded" with an additional housing allocation of £80,000 for agreeing to comply with the voluntary moratorium. We are now seriously considering increasing expenditure in 1984–85". However, the level of "overspend" cannot be forecast with any accuracy. Estimates have fluctuated wildly, from under

* The difference between the lowest and highest tender for even a small local authority capital scheme can easily be 30–40%.

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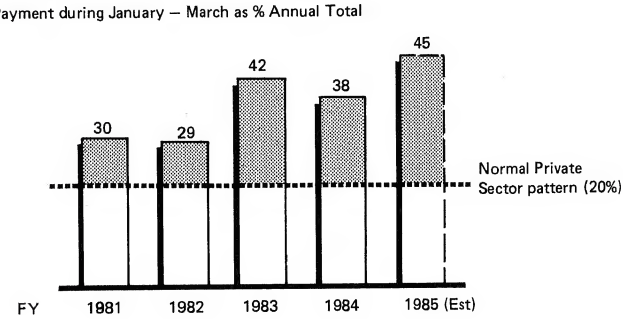
£400 million to well over £1 billion. And, of course, the capital allocations for 1985–86 have to be issued long before the final outturn for 1984–85 is known.

26. The annual cash limits and uncertainties about future allocations and freedom to use capital receipts have other unintended consequences as well. First, authorities are reluctant to give up any of their allocations; in 1983–84, only 1% of allocations was transferred to other authorities. Second, the rush to spend before the year end has if anything increased, despite the introduction of tolerance measures to allow a 10% carry forward. Leading private house builders expect a fairly even cashflow during the year, with the last (January-March) quarter accounting for around 20% of receipts from private sector clients. Exhibit 4 shows that local authority payments follow a very different pattern; and the tendency to increase payments towards the year end has increased markedly since the new system was introduced.

Exhibit 4

CAPITAL PAYMENTS DURING LAST QUARTER – ENGLAND



Source: DOE Quarterly Return of Payments
Housing and Construction Statistics, March 1984

27. Spending in haste in this way is certain to lead to waste unless the authority has appropriate contingency plans in place – which is, unfortunately, the exception rather than the rule:

- To the extent that work is put in hand during the worst time of the year (from a building point of view) construction costs will be higher than they might otherwise have been.
- If work is prefunded, local authorities incur additional costs in arrangement fees of perhaps ½% plus legal fees; and where payments are actually made in advance there is also the loss of interest on the premature payment.
- Professional firms will charge for the extra costs they will incur in meeting tight deadlines for the development of plans and letting of contracts. And since all authorities are in the same position, it can often be difficult to let contracts at reasonable prices. One metropolitan district found it impossible to find contractors willing even to quote for reroofing contracts in late 1982 because

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they had so much work at attractive prices from neighbouring authorities.

- Longer-term projects will inevitably give way to expenditure which can be mounted quickly and which has limited revenue implications (e.g. 'black-topping' roads), whatever the longer term value for money.
- Cashflows are manipulated, distorting the information system and masking the "true" underlying trend in expenditure.
- Contract negotiations will be rushed. This can be particularly expensive in the long run, as contracts shift from a lump sum, based on schedules of rates and bills of quantity to cost-plus arrangements, reflecting target man-hours and costs.

28. Finally, local authorities are able to go beyond the recognised means of adding to allocations, if this should prove necessary. Two accepted and effective ways are, deferred purchase schemes which allow large projects to be financed over a prolonged period; and revenue payments to companies which then take responsibility for incurring the capital expenditure*. Of the 20 authorities visited only one had found it necessary to seek further flexibility through a deferred purchase scheme. Similarly only one authority had created a company to which payments were being made under Section 137 of the *Local Government Act* of 1972. Any further restriction on the availability of capital receipts will make these expensive financing routes more attractive.

INEFFICIENCIES RESULTING FROM THE SYSTEM

29. The present system for controlling local authorities' capital expenditure on a year-to-year basis is resulting in the following unnecessary inefficiencies.

(i) Projects are often delayed by the need to discuss the details with officials.
(ii) There is a risk that project appraisals will be hurried (or even non-existent) when authorities need to commit capital expenditure before the year end.
(iii) Costs are increased by abrupt reductions in capital programmes.
(iv) Assets remain under-utilised, because many authorities consider that the incentive to sell off assets that they do not need in the short term is not worth the longer term risks.

Each of these problems is described in more detail below.

Delayed Projects

30. Time is money, especially where capital projects are concerned. Table 5 below illustrates the costs of an unexpected 12 month delay to an inner city council house renovation project that was originally estimated to cost £5 million and to take three years to complete – assuming that the delay means that the authority will have to place 450 homeless families in temporary accommodation during the extra year.

Table 5: IMPACT OF UNEXPECTED TWELVE MONTH EXTENSION
Illustrative £5 million housing project, £000

Factors	
Cost inflation	£375 k
Extra supervision and design costs	225
Rent foregone, extra cost incurred	1090
Interest saved	(600)
TOTAL	1090 (22% of planned cost)

* Contributions to companies which are subsequently used for capital expenditure by those companies should be treated as prescribed expenditure. In practice, this may not always be easy to determine.

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Appendix C provides three other illustrations of the costs of delay to fairly typical capital schemes.

31. There are two main reasons for delays to projects: project controls exercised by central government departments and difficulties matching annual allocations to capital project timetables – even though the authority has the necessary funding in place. Fieldwork for this study suggests that both types of delay are not uncommon.

Project controls

32. There is no separate capital allocation block for Home Office services and authorities must seek borrowing approval for individual projects which often involves delay. While there is widespread recognition within local authorities of the value of central design advisory services (such as are operated by the DES and DHSS, for example) delays in projects remain frequent, particularly in housing and education; and the administrative time and costs involved are often considerable.

33. As far as housing projects are concerned, DOE approval is required for all new dwellings and for improvements where the authority receives housing subsidy. Six of the ten housing authorities in our fieldwork sample reported no significant central government delays in approving projects. However:

- Although consent is automatic if the Secretary of State fails to reply within 20 days, all the submission costs are incurred at the local level. For example, a borough council submitted details of a £15,000 improvement scheme to DOE no less than three times, (at the design, tender and practical completion stages) completing a 31–question form (PC/2) and providing a general description of the project and the work on each occasion, and submitting each return for Committee approval before despatching it to DOE. It is likely that the extra administrative costs alone of filling in the various forms required by DOE exceeded £600 or 4% of the forecast cost of the project. This is not an isolated incident; other fieldwork authorities report similar orders of magnitude for the extra administrative costs per project arising from the existing DOE controls.
- As stated earlier, 79 housing authorities accounting for 32% of council house stocks will be receiving housing subsidies; and all the authorities in this situation in our fieldwork reported significant delays.
- The experience of one authority visited was that up to June 1984 only 11 schemes had been rejected out of 150 submissions for modernisation. However, nine schemes had been rejected in July and August 1984 alone, due to a new quantity surveyor supplying more "realistic" estimates. If a scheme is rejected it becomes a matter of guess-work how much to knock out to gain approval. All but one resubmission had been approved at the second attempt.
- The key test made by the DOE is the ratio of "value" to expenditure. Acceptable ratios are not published, but an authority "gets the feel" of what will succeed. This process involves the authority assessing the unimproved and after-value of the project. An example of a twice-rejected scheme for a five-bedroom house illustrates the point:

unimproved value	£60,000
cost of proposed works	41,000
estimated improved value	90,000
ratio (101:90)	1.12

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There is an element of unreality in this process since there can be little confidence in this kind of valuation. Presumably an experienced officer can manipulate the process, since such values can rarely be challenged. Moreover, this approach discriminates against small projects designed to provide a "lift" to a depressed neighbourhood or estate (since improved values in such areas will still be low).

- A further example of a new-build submission for the £1.065 million cost of a sheltered housing scheme in London illustrates another flaw in the process. The estimated value when completed was £644,000; and the scheme was rejected. £30,000 was deleted from the estimated cost. The scheme was then approved when resubmitted. Not only is it difficult to establish values for sheltered housing but there is no monitoring mechanism to make sure that the items deleted were not reinstated subsequently – which they were!

34. There are also tight controls over individual education projects, regardless of the position of the authority in relation to target or GRE. All LEA building projects costing £120,000 or over (and all special school projects) are subject to approval by DES. Authorities may submit particulars for "automatic" approval if standards are complied with and if the cost on tender is within 10% of the formula-based DES guideline cost. Where an LEA expects that a project will not comply with the guideline it is asked to negotiate a "target cost" with the DES territorial architect; and if the target cost is met on tender, the project receives "accelerated" approval. These arrangements were introduced by the DES as part of the relaxation of central government controls over local authorities and its stated aim was to have the majority of schemes receiving automatic approval. However, authorities have not made sufficient use of the "automatic" route to enable this to be achieved and most projects continue to be submitted for more detailed consideration. The situation in a large education authority with responsibility for an inner city area is instructive. The authority submits a large number of re-modelling projects each year and the officers in the DES and the authority have established a working relationship which involves continual negotiations throughout the year. Notwithstanding this knowledge of the system over one-third of schemes submitted by the authority fail at the first submission.

35. Detailed project controls are not confined to housing and education. As was mentioned earlier, most road schemes costing over £1 million are monitored individually by the Department of Transport; and the Home Office reviews and approves all capital projects costing more than £8,000. There are tight cost per hectare yardsticks applied to projects for reclamation of derelict land under Derelict Land Grant Aid.

36. Project controls, certainly in the education field, are more relaxed in Wales than in England. For example, following a Rayner Study, the control procedures in the area of education now simply require an authority to notify the Department of an intention to spend above the threshold level in order to secure the formal approval required by legislation. The applications are, therefore, not scrutinised by the Department's architects nor are they the subject of discussion with local councils. The arrangement is the bare minimum necessary to comply with the relevant statute.

Financing delays

37. It is not uncommon for attractive projects to be delayed because of strict adherence to the letter of the regulations governing prescribed proportions of capital receipts – even though the necessary funding to complete a project is in place. For example:

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In Surrey, a district council in its search for ways of reducing revenue costs, recognised that considerable savings would flow from the merging onto a single site of two administrative offices which are seven miles apart. The best marketing of the spare site would be when vacant possession could be offered; so other capital receipts would be necessary in the short term to bridge the project. To meet this need a land sale has been set up. Table 6 shows the results of applying the then current rules relating to the use of capital receipts made under the *Local Government Finance Planning and Land Act 1980:*

Table 6: CASHFLOW FORECAST
£000

	Available resources	Planned project expenditure	Surplus/ (shortfall)
FY 1984	£45 k	45	–
1985	1,250	1,700	(450)
1986	1,625	730	895
1987	1,260	25	1,235
	4,180	2,500	1,680

The council clearly had the resources in the then prescribed proportions of receipts to fund the project, but a shortfall of "resources" occurs in 1984–85 and the DOE was asked to consent to spending in excess of 50% of capital receipts in the year 1984–85 to the extent of £450,000 should this prove necessary. This consent was refused – DOE could not, in law, have agreed. But a worthwhile project (in the council's view) was prejudiced as a result.

Risk of Rushed Project Appraisals

38. The old adage that "time spent in reconnaissance is seldom wasted" is particularly true of capital projects. Value for money must be designed into schemes; and mistakes or omissions at this stage are invariably expensive later. Deciding in haste to proceed with a project is a recipe for the waste of public money. Once a project has been let, there is relatively little scope for influencing the eventual cost. Auditors' reports after the event all too frequently demonstrate the consequences of rushed appraisals: under-utilised facilities or equipment because the expenditure was not really needed at the time that it was made, excessive contract prices, construction cost over-runs, unnecessarily high running costs.

39. To avoid the risk of these problems, any sizeable capital project – i.e. costing over £1 million (say), needs to be subject to critical professional scrutiny. This is, of course, the practice in all well-managed authorities. CIPFA has suggested and the Commission agrees that for all large projects, a report should be prepared answering questions such as the following:

- Is the project really necessary, now? Is there any other way in which the need can be met? For example, the Commission's report *Managing Social Services for the Elderly* shows that there are lower cost alternatives to building new homes for old people including:
  - More community support and closer liaison with health authorities.
  - Providing sheltered accommodation.
  - Taking advantage of the local expansion of private residential accommodation for the elderly.

  For almost every scheme there will be options to consider.
- How should the project be funded? Freehold, leasehold and

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shortlet options all need to be evaluated. Joint ownership of council housing (where a building society advances a mortgage on 50% of the value of the dwelling with the authority owning the balance) has enabled some authorities to house two families for the cost to the public purse and PSBR of one.

- Are lifetime costs being taken into account? The running cost of projects needs to be considered. It is tempting in the search for economies to prune the estimate for a project which might lead to lower construction costs but higher running costs later. Indeed, during the fieldwork, numerous examples were cited of professional advisers to central departments taking such an approach ("you are building [the school] for 20 years; so you don't need. . ."). Energy conservation, maintainability and economic staffing need to be explicitly considered at the project appraisal stage – before building begins.
- Is flexibility built-in? Can the assets be used for other purposes if for some reason the expected need or demand does not materialise? For example social services facilities can be designed to cater for more than one group of clients (e.g. the elderly and children in care). School designs can take account of possible community uses. And so forth.
- How will the construction project be managed? Particularly with larger projects, the management arrangements need to be spelled out in advance. In particular, the role of any outside consultants, their basis of employment and remuneration need to be agreed. Procedures for agreeing changes to specifications also need to be laid out in advance.
- Who should be invited to tender and how should the bids be evaluated? The selection of potential suppliers is also a process that needs care and attention – and is particularly important if price rings are to be avoided.
- What could go wrong, and how is the authority going to manage the main risks? At minimum, a project appraisal should draw on the practical experience of other authorities who have implemented similar projects to ensure that it has anticipated the likely problems both in construction and subsequent operation.

Finally, once tenders have been invited, the qualifications and experience of the competing suppliers will need to be scrutinised with care, appropriately detailed contracts negotiated, referees contacted and so forth.

40. It will be apparent that these questions cannot be answered in any detail for a sizeable project (and many local authority schemes would come in this category) in a rush. It will be quite reasonable to expect a capital project appraisal for a £2–3m project to take 3–4 months of intensive effort, especially if there is an element of competition involved – in the sense that choices need to be made between one project and another. A typical metropolitan district with an annual capital programme of around £25 million might initiate two or three projects of this size every year.

41. The frequent changes that have taken place in allocations, combined with pressure to avoid underspending on an annual basis, have meant that many projects have been carried forward without adequate prior evaluation. Waste later is the inevitable consequence. The problems of two large projects illustrate the risks inherent in rushed project appraisals. The original contract for the first was let hurriedly in 1976, to "beat" changes then in prospect to the regulations governing capital expenditure in local government. The total estimated cost of the project was then almost £7

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million. The project was, in effect, designed as it was built; and important changes were introduced to meet international competition for the conference business that had not been anticipated when the contract was let. The eventual cost of the centre will certainly exceed £30 million. The second project is another example of the same situation: originally estimated at £50 million, the eventual cost will exceed £150 million – again due to failure to plan ahead effectively in sufficient detail*. Neither of these examples can be attributed to the effects of the 1980 *Act*, which was not in operation at the time; but they illustrate the risks of inadequate project appraisals caused by undue haste to commit capital funds before the year end. Auditors regularly point to less notorious examples at the local level.

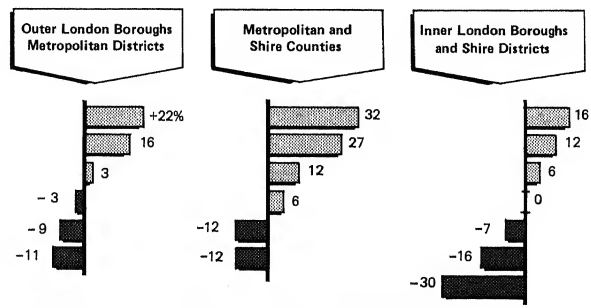
Increased Costs

42. As Exhibit 1 showed, until the surge in capital spending of the past two years (financed from the capital receipts of earlier years) the trend in total capital expenditure had been steadily downwards in real terms since the first oil crisis. Next year will see a resumption of this trend, with many authorities facing reductions in capital programmes of 30% or more. The exact extent of the adjustment required to expenditure plans for 1985–86 only became clear to authorities, with the arrival in late December/early January of the allocations for the year and the change proposed in late 1984 in the prescribed proportions. The changes are unpredictable, as Exhibit 5 shows. Since all material capital projects involved lead-times of at least 6–9 months, authorities had to "guess" last summer both what their allocation was going to be for 1985–86 and the prescribed proportion of capital receipts for the year. The cost implications of sharp reductions in capital programmes are serious, especially if the authority failed to anticipate accurately the extent of the reduction that would be called for.

Exhibit 5

CHANGE FROM PREVIOUS YEARS' ALLOCATIONS IN FIELDWORK AUTHORITIES – FY 1984

% change from FY 1983 Allocations



Source: Study Team analysis of information in Fieldwork Authorities

* Some 55% of the difference between the estimate and likely outturn was attributable to variations in the original design for the project.

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43. For example, one metropolitan district with a current capital programme of over £30 million planned last summer on the basis that it would be spending £25 million in 1985–86. In the event, the programme will need to be cut to under £20 million with these consequences:

- The programme for council house renovation has been cut back from 460 units on four sites to 100 units on three sites. National contractors are, generally, not interested in bidding on renovation contracts for 75 houses or less; and there are substantial scale economies on renovation contracts e.g. in design and site preparation. Experience suggests that unit costs will be 20–25% higher than might otherwise have been expected with the original programme.
- A sheltered housing project has had to be scaled down from 31 dwellings (in two stories) to 13 units on the same site. Because the 13 units are bungalow-style, the construction cost per dwelling will be at least 20% higher; and, of course, much less effective use is being made of the available land.
- An urban renewal project, involving some 60 private dwellings and 30 new houses and flats built by a Housing Association will be deferred, for at least 18 months.
- Consideration of secondary school reorganisation in the district has been deferred, since members are not willing to discuss possible closures of two schools when they cannot promise to up-grade the schools that will remain.
- Preparatory work on the cancelled projects has had to be written off and the reduced programme will mean that manpower will need to be reduced by 15 – assuming that design work now done by the private sector (20% of the total) is brought back in-house. If the private share remains constant, the number of redundancies will rise to over 30.

It is arguable that the authority (and many others like it) would not have incurred these costs if it had planned sufficiently well in advance and members had not "promised" their electors that particular schemes would go ahead. But it is, regrettably, the fact that many authorities do not have detailed contingency plans; and no expenditure control system can safely assume that politicians will not make promises.

Under-utilised Assets

44. Despite the sales of council houses under the Right to Buy legislation, many local authorities still have very considerable under-utilised assets. Any observer will notice the boarded up council flats and vacant sites in many inner city areas. Some void properties are inevitable; but, as the Commission pointed out in its report *Bringing Council Tenants' Arrears Under Control*, voids in London are around double the average level (2% of dwellings) normally accepted as necessary. And, of course, many authorities keep under-occupied schools open because of the difficulties they believe would be involved in rationalising capacity*. Moreover, it has been estimated that local authorities own 60,000 acres of land surplus to their foreseeable requirements; and smallholdings which amount to almost 400,000 acres could be sold.

45. However, the pace at which council house sales are being completed is slowing markedly as Exhibit 6 shows. At the end of 1983–84, there where only 97,000 applications for council house purchases outstanding – around six months sales at the 1982–83 completion rate. Over the five years to the

* Some 55% of the difference between the estimate and likely outturn was attributable to variations in the original design for the project.

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end of March 1984 total sales in England amounted to some 620,000 dwellings. Sales have been proportionately greater in shire districts where capital needs are, in general, smaller; and they have been slowest in London. Table 7 shows the breakdown of sales by class of authority, as shown in the relevant CIPFA statistics.

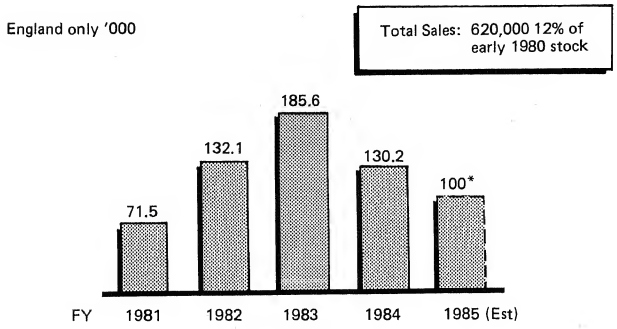
Table 7: COUNCIL HOUSE SALES TO MARCH 31, 1985
ENGLAND

	Sales April 1981 – March 1984	% Council dwellings at March 1981
London boroughs (inc. GLC)	50,600	5.8%
Metropolitan districts	115,200	7.5
Shire districts	282,200	10.0
	448,000	8.6

The situation differs markedly between authorities within the same class. Some shire districts, for instance, have sold well over 20% of their housing stock. The sales level depends primarily on the nature of the houses for sale and the local housing market.

Exhibit 6

TRENDS IN COUNCIL HOUSE SALES : FY 1981–1985



* Applications outstanding at end FY 1984 were 97,080

Source: DOE

46. But the "will' of the local authority is also an important factor. Some need no further incentive to sell council houses other than the prospect of using the receipts to pay off debt and save on their interest charges. But others, whose political preference is to retain assets within the public sector, are deterred from pressing ahead with sales unless the receipts can be used to finance needed expenditure locally. For these authorities, it is always possible to find ways of delaying sales even where provisions are mandatory; and, where they still have discretion, sales will simply not take place.

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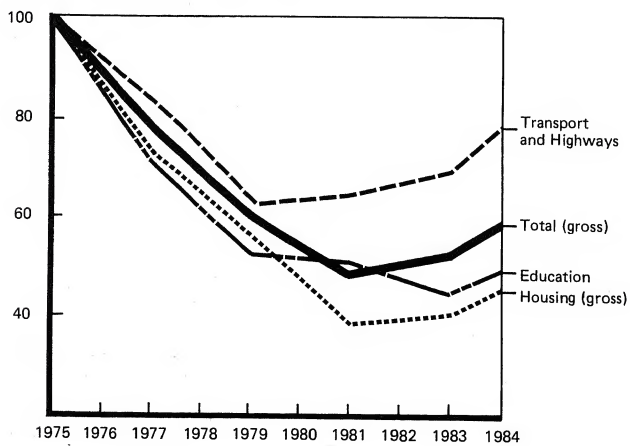
47. The two most important incentives are a reasonable selling price and the ability of the authority to have control over the ensuing receipt. In the case of non-housing assets, local authorities still control selling prices. In the case of housing sales, however, many authorities have generally regarded the discounts as being over generous; and the recently announced increase will no doubt strengthen this view. [But the figures in Exhibit 6 and Table 7 above tend not to support this position.] The most obvious deterrent to asset sales is the lack of flexibility available to authorities in how they can use their capital receipts. At this stage it is important simply to note that the state of the local housing stock, and the incentives in the system for potential purchasers and authorities, have not been sufficient for those authorities with the greatest need for capital expenditure to sell more than around 6% of their housing.

RUN-DOWN IN CAPITAL ASSETS

48. The impact of the systems for controlling capital expenditure on local authorities' *effectiveness* must be reflected in the degree to which it enables local authorities to maintain and improve the physical fabric of the towns and countryside. It is also the most difficult aspect to assess since the questions of need, aspirations and priorities are largely subjective. Furthermore, a full and detailed analysis of these questions was outside the scope of this study. All that can be attempted here is to indicate how the relevant government departments and the local authorities view the system for its adequacy and its capacity to encourage spending on the priorities of both parties. In answering these questions it should not be forgotten that the ability of the system to enable authorities to meet spending needs is not government's first priority – which is to keep aggregate public sector expenditure and borrowing down to target levels. Departments and authorities are therefore committed to compromise within the overall constraints of the system.

Exhibit 7

TRENDS IN LOCAL GOVERNMENT CAPITAL EXPENDITURE
At 1980 Prices; Index: FY 1975 = 100



Source: Analysis of Local Government Financial Statistics (see Appendix D)

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49. The way in which authorities are able to enhance their allocations has already been described. They also possess further flexibility, by being allowed to transfer allocations between services and between each other. It is therefore appropriate to consider the impact of this total aggregation of resources on the perceived needs of local authorities in housing, road maintenance and education since these three services accounted for over 70% of total local authority capital spending. As Exhibit 7 shows, capital expenditure has reduced sharply since the first oil crisis in real terms. Appendix D provides the details. Table 8 summarises the trends since 1974.

Table 8: TRENDS IN LOCAL AUTHORITY CAPITAL EXPENDITURE
£, at 1980 prices

	1974	1978	1982	% Change 1974–1982
Housing: per LA dwelling	£ 823	605	275	– 67
Education: per pupil	129	70	52	– 60
Roads: per million vehicle miles	3,650	1,805	1,720	– 53

50. The figures understate the extent of the decline in that some expenditure previously met from revenue has been capitalised in recent years, as authorities have come under increasing pressure to reduce revenue spending and avoid penalties. Moreover, falling school rolls often generate a requirement for more capital expenditure on school buildings (though not on a per-pupil basis, necessarily) to facilitate local reorganisations.

51. However, a decline in capital expenditure levels is not, of itself, evidence that needs are not being met: previous spending levels may have been wasteful or the level of need may have changed. The rest of this chapter therefore considers some of the evidence about levels of investment in council housing, school buildings and road maintenance in particular.

Housing

52. Housing is the single largest block within local authorities' capital programmes, accounting for up to 50% of total expenditure. As the Exhibit shows, real expenditure on local authority housing has declined by around 60% in real terms since the peak year FY 1975, even after taking account of the sale of council houses referred to earlier. While it is not part of the Commission's role to challenge central or local government's housing policy or spending priorities, many organisations and authorities have urged the need for more rather than less capital spending on housing improvements. They cite evidence such as the following.

- The English House Condition Survey of 1981 summarised its findings on housing conditions at that time as follows: 2,006,000 unfit dwellings, dwellings lacking amenities and dwellings requiring repairs of at least £7,000; and 2,326,000 dwellings requiring repairs of at least £2,500 but less than £7,000.
- By 1986 there is likely to be a housing shortfall of almost 500,000 dwellings in England and Wales. There are already some 1.2 million households on local authority waiting lists; almost 200,000 sheltered dwellings are needed to meet the urgent requirements of the elderly and physically disabled and there are over 80,000 families registered as homeless in England and Wales.
- Over 190,000 families are living at a density of over one person per room; over 60,000 are living at a density of more than 1.5 per room.
- The AMA estimates that the design and construction faults in some one million industrialised and system-built dwellings constructed in the 1960s and early 1970s may well cost over £5,000 a

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unit (at present prices) to correct*. A further 500,000 properties built immediately after the Second World War using non-traditional methods need major repairs likely to cost a further £5 billion.

53. These figures, if substantiated, imply a housing construction backlog of around £30–40 billion at current prices, of which at least half could fall on the local government sector. On this basis, and against a background of planned expenditure next year of around £2.3 billion for all housing purposes, local authorities face a backlog of new building and renovation and major repairs to the existing stock of 4.4 million dwellings of perhaps £15 billion – the equivalent of major repairs to the external fabric of fewer than one in three of the current local authority housing stock.

54. This figure is not wholly implausible. The routine maintenance backlog for council houses has alone been building up at the rate of not far short of £1 billion a year for a number of years. Guidelines issued by the Royal Institute of Chartered Surveyors suggest that routine maintenance should amount to 1.8% of the insured value of the property. This implies, for an average council dwelling, annual maintenance expenditure of around £450 per dwelling – about the level incurred by councils (such as North Devon and Arun) using private contractors to carry out programmed maintenance, after adjustments are made for the age of the housing stock. Average maintenance expenditure per dwelling in 1984–85 will be around £280 a dwelling – a shortfall of £170, before any efficiency considerations are taken into account. Assuming a real maintenance shortfall of £200 per dwelling, the total maintenance backlog will have been building up at the rate of *at least* £900 million a year at 1984 prices over the past several years – reported maintenance expenditure increased in real terms between 1979–80 and 1984–85, by over 45%. As a result, many council dwellings (particularly many of the close to one million dwellings built before 1945) now need major renovation. This is a charge to the capital programme in many authorities. And on top of this, the bills for the design and construction faults in system-built and non-traditional housing are now being presented.

55. The Commission recognises that many of those urging the need for increased investment in improving the fabric of the existing local authority housing stock could be said to have a vested interest in the outcome; and some of the evidence is, no doubt, open to question. It is obviously essential that the English House Condition Survey is updated, with a larger sample covering local authority housing; and that the survey pays particular attention to the problems of system-built and non-traditional housing. The Commission understands that such a survey is now under active consideration within the Department of the Environment.

56. In the meantime, it is clear from the published reports of many independent observers that there are particular problems in deprived inner city areas. The following quotations illustrate some of the views that have been expressed.

– "Nothing has done more to shake confidence in local government than the form much of the new housing has taken. In place of streets have come estates, some high rise, some not. The claims of relationship and friendship have not on the whole been recognised. Even twin sisters would be lucky to get re-housed near each other . . . communities which took generations to build up have not been kept together . . . more often they have been scattered

* A recent tender in a northern city for the re-modelling of a tower block of 170 flats to make it re-lettable (the alternative to re-building) was let for £2.6 million, over £15,000 a unit.

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by a bureaucracy that seems to many local citizens to have no heart". (*Report from Hackney*, Policy Studies Institute, January 1981).

- "Many [estates] have become "dumping grounds" for the poorest, most disadvantaged families, as "better" tenants have moved . . . very modern estates with the more up-to-date amenities are also hated for their long dark corridors and balconies and monolithic style. They provide havens for skate-boarders, go-kart fans, and, in some cases, young muggers; they echo noise; they invite abusive graffiti; the lifts are regularly smashed. Some modern estates also suffer from physical defects, of which the most notorious are water penetration, condensation and unsuitable heating systems". (*Priority Estates Project*, DOE, 1980).
- "Housing register applications show no sign of abating: over 4,000 new applications were received last year, the majority in considerable housing need. About 50% of those registered lack at least one room; 75% share a bath or shower; and 13% have medical problems aggravated by their current housing conditions. A separate transfer list is maintained for existing council tenants and currently stands at 3,600, 70% of whom are in a priority category. Homelessness is the single most urgent housing issue. During 1983, 1,517 families were accepted as homeless . . . at the beginning of August 1984 there were 882 households in temporary accommodation, 548 of them in bed and breakfast . . . expenditure on temporary accommodation has been estimated at £2.45 million for the current year". (*Cross Council Review*, London Borough of Brent, December 1984).

57. Of course, informed opinion can be wrong – or at least exaggerated. To obtain an independent view, in the course of the fieldwork for this study the housing situation in a northern metropolitan district with 37,000 council houses was examined. The authority in question is reasonably typical in that 25% of the local housing stock is council owned, about the national average. Over 10% of the stock has been sold to tenants and the authority has been an enthusiastic supporter of the Improvement Grant initiative to private owner-occupiers. In one respect, the authority is better placed than some neighbouring districts: there are very few high rise blocks and none are system-built. The local situation can be summarised as follows:

- The total capital investment needed to prevent further deterioration of the local building stock is conservatively estimated at not far short of £200 million.
- There is a waiting list for council housing, which is updated annually to be sure that it is current, of over 12,000; over 4,000 of those on the list require elderly persons accommodation (half of these applicants are currently owner-occupiers).
- As Exhibit 8 shows, completions have declined sharply from a peak of almost 1,000 a year to under 50 now; all new houses built are for old people.
- Next year's capital programme for housing will be £11.8 million, of which £5.6 million is already committed to the private sector, for improvement grants. Table 9 shows the trend and near term outlook.

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Table 9: CAPITAL EXPENDITURE ON HOUSING
Metropolitan district example, £million

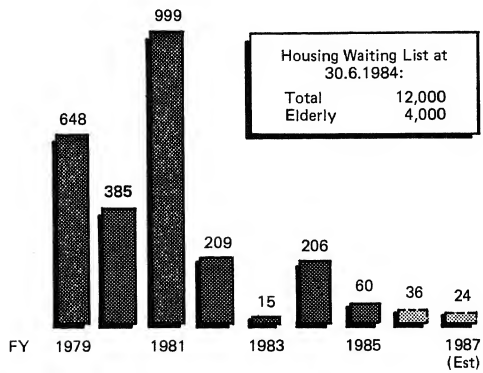
FY 1982	£ 9.8m
1983	16.2
1984	19.9
1985 (est)	16.0
1986 (budget)	11.8
1987 (forecast)	10.0

Exhibit 8

METROPOLITAN DISTRICT EXAMPLE

HOUSES COMPLETED, 1978-1985

Number



Source: Analysis of Authority records

58. The Commission takes no view on the precise level of capital expenditure required on public housing over the next few years. More information is needed before sensible judgements can be reached. However, the Commission is concerned at the evidence of under-maintenance of council houses. Moreover, there are clear risks in under-estimating the need for more investment in improvement of the council house stock – whether this is to be funded from the revenue or capital accounts. It may continue to deteriorate to the point where a "crash" programme is required. Such a programme will immediately run into labour, equipment and materials bottlenecks. Prices will rise; the building industry will be disrupted; there will be calls for a new approach. Local government has seen such a situation before. The result was system-building; and the bills are now falling due.

59. So the Commission concludes that, for the purpose of devising controls over capital expenditure it would be prudent to plan on the assumption that capital spending on council house improvements will need to rise above the level planned for 1985–86, of under £2.3 billion – if only to prevent further run-down of authorities' existing housing stock.

School Building and Maintenance

60. In 1983–84 local authorities collectively requested £580 million to meet their capital spending needs for education. In response to this bid, allocations of £220 million and £74 million were made for schools and

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further education respectively. The seriousness which local authorities attach to their bids can be judged from the fact that they added a further £113 million from other service allocations or from capital receipts. The ten education authorities in the fieldwork sample were asked to provide details of their bids, allocations and expenditure. Their replies are summarised in the following table:

Table 10: BIDS, ALLOCATIONS AND EXPENDITURE: Sample LEAs, £million

	FY 1982	FY 1983	FY 1984	FY 1985
Bids/Programme	£34.2m	35.6	34.6	43.9
Allocations	32.8	27.3	27.9	26.5
Expenditure	30.5	35.5	32.7	n.a.
[% 'Discount' between bids and allocations	4.1%	24.3	19.4	39.6]

As will be evident, the gap between bids and allocations is widening. It should be noted that in years up to and including 1983–84 local authorities did not make a comprehensive bid to the DES in respect of all school-related expenditure; their bids (and subsequent allocations) only covered capital costs of the removal of surplus places, and expenditure on land and equipment. They also provided numerical information on basic needs for additional places.

61. The Department of Education and Science and local authorities agree that the single greatest capital expenditure priority in education is in connection with re-modelling and restructuring of schools in order to take out places surplus due to falling school rolls. In its recent report, *Obtaining Better Value for Money in Education: Aspects of Non-Teaching Costs in Secondary Schools,* the Commission draws attention to the fact that LEAs are falling seriously behind their (modest) plans for taking surplus secondary school places out of use. This report also draws attention to the large shortfall in programmed maintenance (revenue) expenditure, illustrated in Exhibit 9 (page 30). The consequent backlog in maintenance can only worsen if capital expenditure on modernisation and renewal is constrained. Eventually, if routine maintenance is cut back too far, capital expenditure will be necessary – some authorities have been capitalising repairs in any case to avoid revenue penalties. One county with a record of relatively generous maintenance expenditure on its schools estimates that it needs to spend an average of £115,000 per secondary school to bring the fabric up to standard. There are some 4,600 secondary schools in England and Wales; so this county's experience implies a renovation backlog of some £500 million.

Transport Infrastructure

62. Responsibility for capital expenditure on highways is divided between the Department of Transport and local authorities. Central government funds the capital expenditure on trunk roads often through the local highway authority as its agent, whilst county councils and the Greater London Council and London boroughs are responsible for all other roads. Because trunk and other main roads are all part of one integrated and inter-dependent system it is essential that the different categories of road are built and maintained in a co-ordinated manner.

63. The view of the Department of Transport is that there is substantial pent-up demand for better roads, both for the business community and for environmental reasons. As Exhibit 10 shows traffic has been rising, at the upper end of the range predicted by the Department, while local authority expenditure on capital schemes has fallen by around 40% in real terms since

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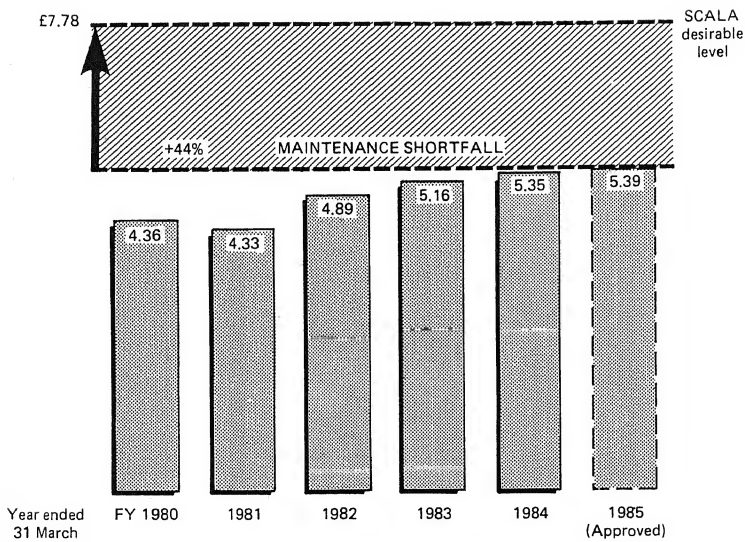
Exhibit 9

SCHOOL MAINTENANCE EXPENDITURE

£/m² committed, adjusted for inflation



Source: SCALA Procedures and Practices Committee, June 1984. Sample returns from 33 counties, ILEA, 12 Outer London Boroughs and Metropolitan Districts.

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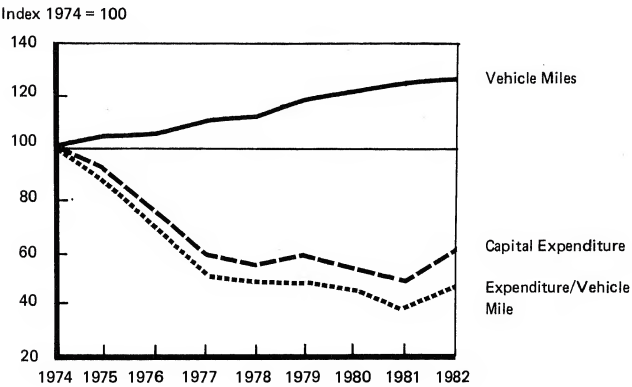
its peak in the mid-1970s (since 1981–82, authorities collectively have underspent their allocations). Annual expenditure per vehicle mile on the maintenance of principal and other county roads is currently (1984–85) some 30% in real terms below the levels of 1975–76.

Exhibit 10

TRENDS IN TRAFFIC AND INVESTMENT IN ROADS AND PUBLIC LIGHTING 1974–1982



Source: Transport Statistics, 1982
DOE

64. Reductions in maintenance do not have a particularly marked effect on the condition of roads during the first 7–10 years of their design life. Thereafter, as Exhibit 11 suggests, roads depreciate rapidly and become progressively more expensive to restore to "as new" condition. The next few years will therefore likely see the costs of deferring road maintenance from one year to the next rising sharply. And, assuming that roads were in sound condition in 1974, there could well be an increase in the need for investment on re-grading and reconstruction to prevent roads deteriorating.

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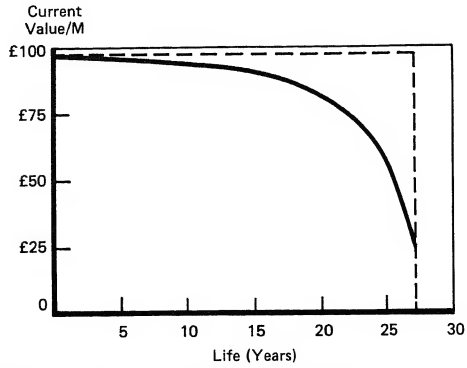
Exhibit 11

ILLUSTRATIVE

DEPRECIATION CURVE FOR CLASS 1, ROADS
1977 Kent Mini-Chart Survey
(44 sites)



Source: Economic Aspects of Highway Maintenance
J. A. Bergg, Chartered Municipal Engineer, July 1978

* * *

65. In summary, the present system for controlling capital expenditure needs reform. It does not meet government's requirement for annual control over local authorities capital expenditure. It involves waste and inefficiency. And despite the application of capital receipts, there is now a large backlog of capital work arising from the failure of many authorities to maintain their housing stock, schools and roads in sound condition.

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2 Underlying causes of the problems

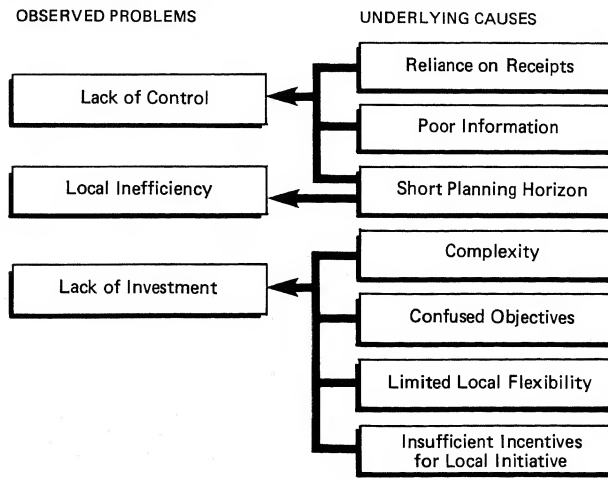
66. It would be tempting to claim that there is nothing wrong with the present system for controlling capital expenditure that would not be corrected by an increase in allocations and/or relaxation of the constraints limiting the use of capital receipts by local authorities. But such a claim would ignore the fundamental reason why many authorities face capital needs which they cannot meet with the available allocations: too often, the "soft" option of reducing maintenance expenditure has been accepted in preference to the more difficult task of reducing waste and inefficiency in services; as a result, capital assets have been rundown and there is a daunting backlog of capital works. The claim would also ignore some of the weaknesses within the existing control systems:

(i) Conflicting system objectives, leading to unnecessary complexity.
(ii) Limited local flexibility.
(iii) Inappropriate, single year, planning horizon.
(iv) Poor information, resulting in central government deciding important questions without the necessary facts.
(v) Insufficient incentives for authorities to take local initiatives to generate new sources of funds for capital expenditure.

Each of these underlying causes needs to be addressed directly in any changes to the present system. They are discussed in turn below. Exhibit 12 shows how the causes and problems are related to each other.

Exhibit 12

UNDERLYING CAUSES OF OBSERVED PROBLEMS



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CONFLICTING SYSTEM OBJECTIVES

67. The government's objectives with the new system may be summarised as follows:

(a) To control aggregate local authority capital expenditure in line with the government's public expenditure plans. Local authority expenditure is seen as part of total public expenditure. Control of public expenditure is deemed essential by government (a) for implementation of the medium term financial strategy to reduce the public sector borrowing requirement, lower inflation and interest rates and (b) for reducing the role of the public sector. It is also helpful for a control system to cover related borrowing, because borrowing for capital purposes is an element of the LABR, itself regarded by government as part of the PSBR.

(b) To encourage the disposal of assets in order to help in the objective of reducing the role of the public sector. The present control system was designed to this end, in conjunction with the right to buy legislation.

(c) To promote a good match between the availability of resources and the incidence of need, within overall government expenditure plans for local authority capital expenditure, taking into account the government's service priorities. This required a measure of control over the distribution of expenditure and/or borrowing. There were two elements: the distribution of resources between authorities and the direction of resources towards the government's own service priorities.

(d) To provide local government with a workable system which promoted cost effective capital programmes and which maximised freedom within the limitation necessarily imposed in pursuit of the other objectives. [Capital projects may have long lead times and the workload has to be planned to match the available staff and other resources].

It will be apparent that these objectives are not invariably mutually consistent. Asset disposals have resulted in the loss of year-on-year control referred to in Chapter 1; local flexibility often conflicts both with national priorities and central project control; local spending priorities do not necessarily match the pattern of asset disposals, as has already been shown (paragraph 45).

68. In the attempt to meet all these objectives, the system has become so complex that, like the block grant distribution system, those that need to operate it often do not understand it. Furthermore, the system often conflicts with what many members of local authorities regard as "common sense". In discussing the system with the study team, local authority members often questioned the purpose and justice of selling council houses when the capital receipts cannot be used to fund new capital schemes directly; and they could not understand why it was not in everyone's interest to save up receipts before embarking on major projects. All the authorities visited during the fieldwork part of the study said that they had been adversely affected in one way or another by the following complexities of the system:

- Capital receipts: when the concept of a prescribed proportion was introduced it was the intention that the non-prescribed proportion would be redistributed amongst authorities and consequently lost as a source of spending power to the generating authority. Only after the local authority associations had maintained that such an interpretation could not be sustained within the legislation did the government finally acknowledge the "cascade" principle. This has lead directly to the current 'overspend' against government

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expenditure targets. In the meantime, some authorities, not knowing the correct legal interpretation, committed themselves to steps which they would not have taken if they had understood the position.

- Tolerance: similar, but even more complicated, legal arguments have surrounded the true interpretation of "tolerance" within the meaning of the Act. The "correct" interpretation has only recently been confirmed in circular 6/84, some three years after the system was introduced. So convoluted do some find the argument that even today some authorities do not understand the true position and are acting incorrectly.
- Notional receipts: the Act has brought into focus as never before, the concepts of spending power and financing source. For example, a capital receipt can be used to repay debt and still support additional spending provided cash can be found elsewhere. Similarly, the capital value of some leases can be counted as a notional receipt and therefore justify capital spending. But, of course, no cash exists. Whilst accountants may be expected to understand these distinctions, it has meant the setting up of a complex system of unpublished accountancy records, which record notional spending power creations and applications. Ratepayers can only be bewildered by such arcane practices.
- Forecasting current receipts: the growing emphasis placed on current as opposed to accrued capital receipts will inevitably lead to more accounting manipulations and possibly to uneconomical behaviour. For example, if an authority is in negotiation to sell an asset and it looks as though the settlement date may fall in the wrong financial year the authority may be induced to settle for less than the best price; certainly an informed buyer is likely to exploit such a situation. Furthermore, an authority may commit prescribed expenditure in the reasonable expectation that a certain level of receipts will accrue. In the event, it may not; and the authority will be without spending authority. The fear of such a situation may lead to inefficient behaviour.
- Non-prescribed expenditure: for example, complex legal clauses have been written in leases to create the impression that ownership is elsewhere than it appears to be. These innovations have to be paid for.

These complexities have several unplanned side effects. Perhaps, most important, they have reduced local accountability and members' concern for value for money. The leader of one authority put it thus: "revenue is very complicated; but with capital they [the members] just switch off. They think that when they vote to build a school, it will be built. They do not worry about the money anymore; they expect the treasurer to find a way".

LIMITED LOCAL FLEXIBILITY

69. Although, in theory, local authorities are accountable to the local electorate for their spending decisions, in practice their flexibility is constrained in important respects by central government. First, and most important, the present capital expenditure control systems involve a large element of central planning. Every year, a total of over 1,200 separate allocations of capital expenditure is issued to local authorities by a combination of the central government departments involved. As Exhibit 13 (page 36) shows for housing, these allocations vary significantly from local authorities' bids, and in unpredictable ways. Part of the variation may be due to exaggerated bids being submitted in the first place, by authorities anticipating reductions. Whatever the cause, central govern-

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Exhibit 13

Discounts vary among authorities and expenditure block from year to year

HOUSING ALLOCATIONS VS BID

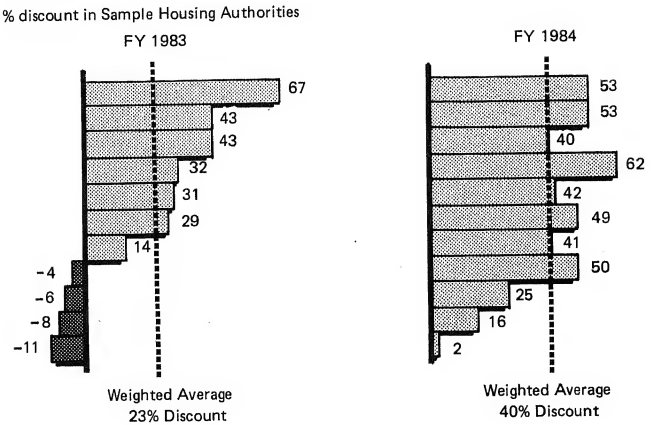
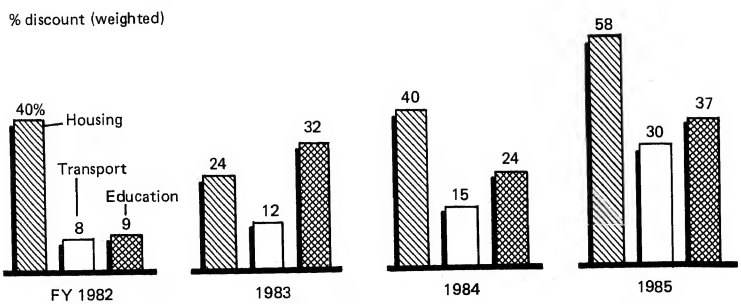


Exhibit 14

ALLOCATION VS BID IN DIFFERENT 'BLOCKS'



Source: Study Team analysis of information in Fieldwork Authorities, 1984

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ment is telling individual authorities in very considerable detail (i.e. to the nearest one-twentieth of a house in the case of housing) what it can afford. It is also in effect influencing local priorities, since in practice as Appendix B (question 3b) shows, authorities are reluctant to move expenditure (i.e. to vire) between expenditure blocks since they fear subsequent problems with the sponsoring department. Exhibit 14 shows that the "discount from bid" varies not only from year to year but also from block to block. Such an approach is prone to the well-known problems of central planning: central government officials, operating with inevitably limited and often out-of-date information, and lacking detailed local knowledge cannot be expected to be better judges of local needs and priorities than members accountable to the local electorate.

70. In addition, the combination of present expenditure control systems, penalties for spending above annual revenue targets and the new *Rates* legislation means that authorities cannot opt to increase their capital expenditure by using other sources of funds such as the non-prescribed proportion of asset sales, efficiency gains, increased charges or by increasing the rate levy. And the system of project controls already described effectively limits authorities' freedom to decide on the quality of local building projects – although the present systems are arguably less restrictive than those they replaced, design and cost standards still mean that key decisions on the appropriate quality of school buildings or council houses are made at the centre.

71. These limitations on local choice have important national implications. For a start, any mistakes tend to be very large ones, since they will be committed by all authorities following the same guidelines. It is worth recalling that central government played a key role in promoting system building in particular. Students of public administration would do well to study the way in which industrialised methods of house building for the public sector were adopted enthusiastically by central government and promoted by the National Building Agency as "sound and suitable for a 60-year loan sanction". With the benefit of hindsight circulars issued by the then Ministry of Housing and Local Government in the period 1965–69 extolling the virtues of system building are striking examples of how wrong "the system" can be, despite the very best of intentions.

72. Just as important, local accountability is inevitably weakened. If local members cannot reasonably be held accountable for the size of the total programme, for local priorities between services and projects, and for methods of financing and quality standards, it should come as no surprise that they are disillusioned and the local electorate disinterested. As one leader expressed it: "In five minutes, I had got rid of it [the capital programme]. It would be a different matter if we could say: are you willing to put 10p on the rates for these schemes? Then they would have to choose, and be prepared to defend their decisions". Again, the Commission does not condone what appears to be an irresponsible attitude. But authority and responsibility usually go hand-in-hand; lack of authority to decide local issues is likely to lead to irresponsible behaviour by members, in the long run.

INAPPROPRIATE PLANNING HORIZON

73. Capital projects take several years to complete. As mentioned earlier, even relatively small schemes can take 15–24 months in preparation before contracts are let. Feasibility studies, sketch designs, working drawings and specification of bills of quantities and evaluating tenders all take time – and involve up to 10% of the eventual project cost. So local authorities need at least a three year planning horizon to feel confident, when setting major schemes in train, that they will be able to complete

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them. In 1983–84, for example, 11 of the fieldwork authorities were implementing a total of 84 major schemes, each involving at least 36 months of capital payments; total payments on these projects amounted to £125 million in the year.

74. The present capital control systems do not provide this longer term perspective. Government's intentions as set out in the Public Expenditure White Paper now only provide details of planned total local government capital expenditure for one year ahead; and one year capital allocations only reach authorities around the turn of the year – less than three months before the beginning of the period to which they apply*. Moreover, changes in the presentation and price bases make analysis of successive PES White Papers somewhat unilluminating. Table 11 shows the details as set out in successive White Papers.

Table 11: LA CAPITAL EXPENDITURE PLANS FOR FUTURE YEARS
England and Wales
£million, cash (except Cmnd 7439, 7841 and 8175)

	FY	1978	1979	1980	1981	1982	1983	1984	1985	1986
White Paper (Cmnd)										
7439 (March 79)		3127	3089	3201	3236	3248	3238			
7841 (March 80)			3014	2958	2487					
8175 (March 81)				3771	2960	2515				
8494 (March 82)					3755	2742	3523			
8789 (March 83)						2638	2264	2341		
9143 (March 84)							2927	3150	2967	
9428 (January 85)								3501	3349	2465

75. There are a number of problems associated with analysis of government's published plans. Most important is the change between 1981 and 1982 when the process moved from a constant price to a cash basis. It is thus not possible to relate the figures in the last four lines to these early years. Secondly, the planning time scale, which earlier extended to four years ahead is now restricted to one year only. Thirdly, the relationship between gross and net capital expenditure is often obscure since it is not always clear how capital receipts have been treated.

76. In addition to these shortcomings, there are frequent variations of plans. The figures for 1982–83 highlight the instability of the background against which local authorities have to make plans and implement capital projects. In 1979 local authorities were advised to make plans to spend £3,238 million in 1982–83 at 1978 prices. At 1982–83 prices this would have been approximately equal to £4,900 million. In the following two years no indication was given whether this figure had changed or not. In March 1982 the plan had been reduced to £3,523 million, £1,400 million less than indicated three years earlier; this in part reflected the increased availability of capital receipts. The following year showed that local authorities were planning to spend only £2,264 million, which a year later turned out to be £2,927 million.

77. Of course, changes in planning totals for local government capital expenditure as a whole are not the most important uncertainties faced by local authorities. Every year, authorities receive allocations for each service block** in response to their bids. The "discount from bid" varies between

* Figures for local authority capital formation three years ahead *are* published. But these do not allow any overall local authority cash limit to be calculated; neither are they of help to individual authorities.

** I.e. housing, transport, education, personal social services, urban programme and other services. For education a comprehensive system of bids only became operative in 1984–85 and no bids are made in respect of other services.

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authorities and expenditure blocks. For example, the discount has recently been higher in housing than in education or (particularly) social services; but since no common pattern is apparent any attempt to forecast these by local authorities is difficult. In any case, the allocations typically arrive less than three months from the beginning of the relevant financial year. Exhibit 13 showed the extent of the "discounts" experienced by the sample authorities in their bids for housing, transport and education. It also shows the considerable variation in "discounts" applied to different authorities and from year to year. The lack of any discernable rationale is striking; it encourages local authorities to devalue the system by submitting inflated bids. Such a practice is, of course, unfair to those authorities who continue to "play by the rules".

78. In addition, every year has seen changes in the system itself which further complicate the task of local management in planning ahead for capital developments. In particular, the prescribed proportion of capital receipts has changed every year in the last three, as government has responded to its perception of local authorities' intentions. Table 12 covers the main categories only. For full details see Appendix A.

Table 12: CHANGES IN RESTRICTIONS ON USE OF PRESCRIBED PROPORTION OF CAPITAL RECEIPTS

	Housing	Non-housing
FY 1982	50%	100%
1983	50	100
1984	50	50
1985	40	50
1986	20	30

Every change of course affects the amount by which an authority can "enhance" its capital allocations. Moreover, the cascade principle means that the changes affect not just the current year, but future years as well. The effect of the successive changes in the prescribed proportion of housing receipts on the possible capital spending of an authority is considerable. For example, an authority with £15 million of receipts in hand and expected receipts of £3 million a year could spend up to £30 million over five years if there were no controls; with average prescribed proportions of 50%, the maximum expenditure over the period falls by 11% to £26.6 million; at 20%, the programme could not exceed £17 million over the period – a fall of 43%. The changes also complicate local planning. For example, Staffordshire County Council agreed to fund the Stoke Garden Festival from capital receipts, at a time when it had unrestricted access to these receipts. The reductions in the prescribed proportion first to 50% and then to 30% have seriously embarrassed the authority.

79. Finally, as described above, there have often been pressures from government in mid-year to increase or reduce expenditure. In late 1982, authorities were urged to increase their capital spending in that year (1982–83). 1983 saw the housing improvement grant initiative. More recently, of course, authorities were requested by the Secretary of State for the Environment to restrain their capital expenditure, the prescribed proportion of capital receipts has been halved for 1985–86, and provision is now to be made partly to compensate authorities complying with the request.

80. The short term uncertainties have another side effect that cannot be intended in those authorities that lack detailed contingency plans. The need for rapid decisions on what to cut from capital programmes means that members are forced to rely on their officers' judgement to an unhealthy

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extent. The leader of one shire county explained that members will have no more than two hours to consider proposals for reducing the previously agreed capital programme for 1985–86 by £10 million. In such circumstances public accountability for difficult decisions must clearly be at risk.

* * *

In short, the present expenditure control systems make it difficult for authorities to plan ahead with any confidence. The result, as described in Chapter 1, is waste and inefficiency – even though the effect of these uncertainties has been masked by the availability of capital receipts from council house sales in particular. But this is not a sustainable position as will be discussed below.

INFORMATION PROBLEMS

81. The Commission's study on block grant indicated that the flow of information between local and central government was in some cases so misleading that there was a risk that wrong decisions would be taken. Furthermore, important information is often received so late that appropriate decisions cannot be made at the right time. This study has revealed that there are similar shortcomings within the present system of capital controls, although there will always be some difficulties in collecting timely information from over 400 authorities. For example:

- In the past the government has had no regular or reliable information on local authority capital programmes. The problems that this can cause are illustrated by the events of this year when government realised, after allocations had been issued, that it needed more information to assess what was happening. [Recognising this shortcoming further information was sought in 1984–85 and from 1985–86 onwards. The government now plans to ask local authorities to provide details of their capital expenditure forecasting and commitments before the start of the year].
- Local authorities provide details of capital payments quarterly in arrears. Such a system has some merit in stable conditions, when it is possible to see changes in patterns of expenditure by comparing present with previous performances. In a volatile and rapidly changing system such information is less reliable; and it can be positively misleading, as in the case of the sharp increase in expenditure in the fourth quarter of 1983–84 which was larger than anticipated.
- The government has limited information on the level of accumulated capital receipts held as cash or spending power. This information is necessary for control purposes and would facilitate a fairer distribution of allocations. [The present Act, however, does not allow the Government to make explicit recognition of receipts when setting allocation for individual local authorities]. Because the government does not know the level of available receipts nor the intentions of local authorities in respect of their accumulated receipts, it has been driven into the unfortunate mid-year initiatives already described.
- Similarly, the government has no information on less usual forms of capital financing such as deferred purchase.

DOE have recognised some of these difficulties by their request for additional information as described earlier in this paragraph. The Commission does not wish to argue that local authorities should be required to provide more and more information. The purpose of drawing attention to the shortcomings above is to underline the need for accurate, timely and appropriate information if complex control systems are to be effective.

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Without such information, control will be lost and ill-informed decisions will be made on the overall level of capital expenditure allocations for local government as a whole, as well as for individual service blocks and authorities.

82. Inadequate information is also one of the causes of anomalies in the allocation of housing investment to individual authorities – housing investment is, of course, the largest single element within the local government capital expenditure programme. As the Commission observed in its earlier report on the block grant system (paragraph 62) "the information on which housing investment programme (HIP) allocations are distributed is also questionable. Every year, in the late autumn, each authority responsible for housing receives a capital allocation for the ensuing year. The allocation is very detailed (i.e. to the nearest £000 – or one-twentieth of a house); and is based on Ministerial discretion and the generalised capital need index (GNI). This in turn is based on information that will be at least four years old [and only some of this information can be updated annually]. The two most important factors – covering dwellings in poor condition and accounting for 50% of the GNI – are derived from the results of the English House Condition Survey which might cover 10 houses in an average authority".

It is debatable whether *any* formula-based approach will be able to assess local housing needs better than locally elected councillors familiar with local conditions and priorities and held to account by the local electorate. Central planning such as is now being practised may be attempting the impossible.

83. The link between housing need and HIP allocations has been further weakened by the recent change, which gives an extra 5% of the basic allocation to those authorities who complied with the terms of the voluntary restraint.

INSUFFICIENT INCENTIVE TO TAP NEW SOURCES OF CAPITAL FUNDING

84. The present system, under which each authority has both an expenditure allocation (in a number of different blocks) and a borrowing ceiling, means that local initiatives have relatively little effect on levels of spending. This is, indeed, the desired result from government's point of view. But the inevitable consequence is a dependent attitude in many authorities, with members and their officers seeking to "play the system"; possible sources of capital finance other than new borrowing are rarely considered in any detail – particularly if they involve difficult management choices. This is unfortunate, since there are often some potentially worthwhile local opportunities to fund extra capital expenditure from:

(i) Revenue savings arising from improvements in economy, efficiency and effectiveness.
(ii) Changes in charging policies, and, in particular, council house rents.
(iii) Further disposal of under-utilised assets.

Each of these is discussed further below.

Revenue Savings

85. The Commission believes that, given adequate incentives and time, most (though not necessarily all) local authorities could reduce their revenue expenditure without compromising local service standards. The sheer scale of local government means that relatively small gains in efficiency can generate very large annual savings. A 10% improvement in efficiency across the board would generate over £2.5 billion a year (assuming that debt charges are fixed). The following table shows the potential gains that appear available in those services or cost areas accounting for around a quarter of total local authority expenditure that the Commission has examined since it came into existence two years ago.

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Table 13: POTENTIAL REVENUE SAVINGS IDENTIFIED BY THE COMMISSION
England and Wales.
Selected services only – 1984 prices

	£m/year	% of costs examined
Non-teaching costs in secondary schools	£180–250 m	20–27
Purchasing	150–200	5– 7
Further education	125–130	6– 8
Transport	125–150	18–21
Refuse collection	30– 50	9–15
Social services (children in care)	20– 30	5– 8
Other services examined	35– 50	not applicable
TOTAL	665–860	9–13 (weighted)

Clearly, savings on this scale, if and when achieved, could provide a useful contribution to financing capital expenditure – provided local authorities are able to channel savings into capital projects without risking their targets and GREs in future years. However, the Commission and its auditors have observed that securing implementation of the necessary changes is often very difficult. Allowing authorities to fund expanded capital programmes from efficiency savings would provide an important additional incentive.

86. Of course, there will be authorities where the scope for efficiency gains is not great – because they have already been realised; and in many places, the need for capital expenditure will outweigh the potential scope for savings. Moreover, it will be necessary to invest in order to achieve many of the revenue savings referred to above. School rationalisation – the key to the bulk of the potential savings in non-teaching costs in secondary schools – almost invariably involves building work. Economies in purchasing also usually require investment in systems development. Similarly, the Commission's studies of refuse collection and transport management have shown that the right equipment is necessary to secure productivity gains and reduce maintenance costs and vehicle reserves and that investment in information technology is the key to reducing central overhead costs. And the Department of Energy has pointed out the attractive returns available from investment in energy monitoring equipment. [Even so, many examples of capital constraints, resulting in the deferral of investments in energy conservation with paybacks of well under 12 months, have been cited to the Commission's staff.]

87. Apart from the need to invest to secure revenue savings, there is a limit to how fast changes can be implemented. Generally, authorities will be able to rely on natural wastage to achieve changes in staffing levels. So the lead time to achieve the available efficiency gains is likely to be of the order of three years. In the meantime, therefore, other sources of capital funds will be needed if the capital programme is to be maintained even at its present level without an increase in borrowing.

Rents and Charges

88. There are some 4.4 million council dwellings in England, by far the largest source of income from charges to users of services. This section therefore focuses on rents, although there is often a need to review charging policies in other services as well. An increase of £2 a week in average rents would generate over £450 million a year in increased revenue, assuming that it could be collected. At present, local authorities and new towns account for some 25% of all dwellings in England, down from 29% in 1971, but about the same level as in 1960. During the past 25 years, there has been a dramatic shift in patterns of ownership. There has been a sharp reduction in private rented accommodation and an increase in home ownership. In 1960, 44% of dwellings were owner-occupied and 31% were rented from

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private landlords. In 1982, the figures were 61% and 12% respectively. During the period, the number of homes available for rent from private landlords fell by some 2.2 million. The fall from pre-war levels of private rented accommodation is even greater, around 4.4 million dwellings.

89. The Commission recognises that determination of rents is a matter of political choice as well as economics. It recognises, too, that housing finance is a complex and contentious field in which it is unwise to consider one part of the housing market (council tenants) in isolation from the rest. This section simply draws attention to the economic consequences – in terms of the funds available for investment – of current rental policies in local authorities.

90. Many local authorities have fixed rents at levels that are insufficient to keep buildings in good repair, as the maintenance backlog referred to above shows. Indeed, the Commission's earlier report on the block grant distribution system showed that only 75 authorities were in surplus on the housing revenue account in 1983–84; 139 were in balance – but only in the sense that they were meeting the outgoings and debt charges on *historic* costs; 159 were in deficit, several by £300 or more per dwelling†. Table 14 below shows the current housing revenue account position for all council-owned dwellings in London, metropolitan and shire districts.

Table 14: RENTS AND HOUSING COSTS – FY 1985
£/week, average for all dwellings

	London	Metropolitan districts	Shire districts
Income:			
Gross rent*	£17.1/week	13.7	14.9
Capital costs (gross)**	21.1	10.5	10.7
Management	6.9	2.7	3.0
Repairs/maintenance	7.2	4.5	5.3
Total costs	35.2	17.7	19.0
Surplus/(deficit)	(18.1)	(4.0)	(4.1)
[Memo: annual deficit	£941	208	213]

* Including any housing benefit.
** Before subsidy, interest receivable and non-rent income.

detached house built in the mid-1930s, as assessed by local rent officers in DOE 'Beacons' studies. Table 14 below shows the current housing revenue account position for all council-owned dwellings in London, metropolitan and shire districts.

Even after subsidies, interest on capital receipts and non-rent income are credited, the average annual deficit per dwelling in London is almost £7 a week and that outside London approaches £1.50.

91. Of course, the situation differs between authorities, as Exhibit 15 shows. Nonetheless, the fact remains that on average rents are not covering outgoings; in London, they are not even covering historic capital costs. The size of the local authority housing stock means that the cost implications are serious.

92. As Hepworth et al* observe the Housing Revenue Account figures are relatively meaningless, since they are based on historic costs and thus ignore the replacement cost of the building. An authority which happens to have a relatively old stock of council property can balance its HRA account with relatively low rents, because it has low capital costs; an authority with relatively new housing stock will have to charge high rents. As stated

†Average local authority rents in 1984 on a pre-1945 three-bedroomed house were over £300 *below* median net annual 'fair rents' for a two-storey semi-detached house built in the mid-1930s, as assessed by local rent officers in DOE 'Beacons' studies.

**Housing Rents, Costs and Subsidies,* Grey, Hepworth and Oddling-Smee, March 1981.

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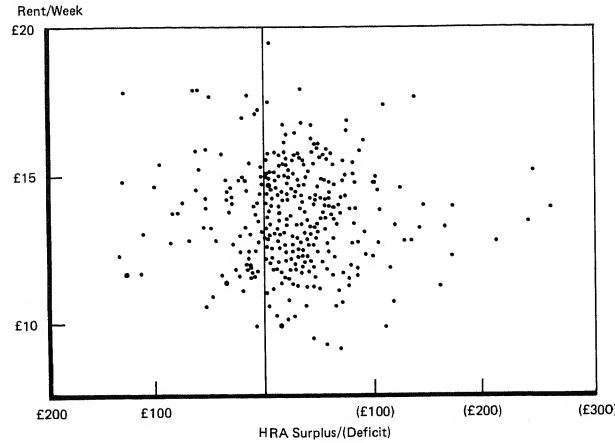
Exhibit 15

COUNCIL RENTS AND HOUSING REVENUE ACCOUNTS (PER DWELLING)

Metropolitan and Shire Districts



Source: Analysis of CIPFA Housing Returns, 1983-84 Estimates

earlier, this approach means that authorities are not, in general, building up the funds needed to meet the costs of major refurbishments to properties. As a result, when major renovations are required (as is the case with many system-built houses now) the local authority and government face an unenviable choice between letting the fabric continue to deteriorate or placing an increased burden on the ratepayers. Often they choose the first option; so the maintenance backlog is the not-so-hidden cost of uneconomic rents.

93. In the discussion document referred to above, the concept of an economic rent for council housing is explored. This may be defined as the sum of depreciation on the property and the opportunity costs – the real annual return that the owner could expect if the dwelling is sold at its current capital value. On this basis, in 1980, the annual net economic rent for a typical local authority dwelling was just under £870 a year, using a 4% discount rate (as a proxy for the opportunity cost). In 1984 terms, the economic rent would be some £1,300, or £25 a week, for a typical local authority dwelling. In fact, as shown above, the average gross council house rent (i.e. before any rebates) outside London in 1984 was under £15 a week, of which supervision and management accounted for some £2.85.

94. In short, many local authorities are now charging rents around half the level necessary to cover the full economic cost of the dwelling. The consequences are clear: houses are not being properly maintained – which may well be one reason why opinion surveys show that many council tenants would prefer to be owner occupiers; at the same time, the uneconomic rent reduces the incentive for tenants to buy their homes (in line with government policy) and inevitably restricts the supply of private rented accommodation. If local authorities felt able to charge rents closer to levels necessary to cover the annual economic cost of the dwelling and could channel the extra income into capital repairs, the state of the local housing stock would be much improved.

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Further Asset Disposals

95. Local authorities have generated significant funds from asset sales over the past few years. Capital receipts over the past four years have totalled almost £8 billion, of which sales of council houses have accounted for around 75% (the approximations reflect estimates for the present year). Nonetheless, the potential should not be exhausted. As stated above, less than 10% of council houses have been sold to their former tenant despite the very attractive inducements; and local authorities in England have over 60,000 acres of land surplus to their foreseeable requirements (this figure excludes small-holdings). Table 15 below shows the situation for typical authorities.

Table 15: ASSET DISPOSALS: APRIL 1979 – MARCH 1984
Illustrative examples

	Shire county	Outer London borough	Metropolitan district	Shire district
Land (hectares)	599	7	1	1
Dwellings	74	2,500	2,300	1,000
Secondary schools	–	–	–	n/a
Memo:				
Property holdings at 31.3.1983				
– Land 'surplus to requirements' (hectares)	63	39	155	4
– Land in small-holdings (hectares)	5,667	–	–	–
– Dwellings	> 500	21,000	37,000	8,000
– Surplus secondary schools	5	8	5	n/a

96. There remains considerable further potential for under-utilised assets to be sold, in order to fund an increased capital expenditure programme. Despite this, partly because of the existing constraints within the control systems, it is likely that over the medium term the trend of asset sales will be downwards unless changes are made. Table 16 shows the study team's best estimate of receipts over the next six years from housing sales, mortgage sales and other sources. The table assumes that a scheme for the sale of mortgages can be put in place next year. On these estimates, capital receipts over the next six years are unlikely to exceed £9 billion, or around £1.5 billion a year – somewhat below the average of £2.1 billion a year for the last three years (FY 1983–85).

Table 16: BEST ESTIMATE OF CAPITAL RECEIPTS
England, £billion,

	Housing sales	Mortgage sales	Other	Total
FY 1986	£1.4 bn	.2	.5	2.1
1987	1.1	.7	.3	2.1
1988	.7	.6	.3	1.6
1989	.5	.3	.3	1.1
1990	.3	.3	.2	.8
TOTAL	4.0	2.1	1.6	7.7

* * *

In short, the waste and inefficiency associated with the present system for controlling capital expenditure seems likely to persist unless the following underlying causes are tackled: complexity, limited local flexibility, one-year planning horizon, poor information and insufficient incentives for authorities to generate funds internally. The final chapter of this report describes, briefly, the need for a new approach.

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3 Need for a new approach

97. The previous two chapters of this report have demonstrated that the present systems for controlling capital expenditure are not consistent with the basic requirements for sound management as set out in the Commission's earlier report on the block grant distribution arrangements. Specifically:

(a) Delegation of authority and responsibility is restricted. Detailed central control is exercised over many projects, particularly in housing, education and urban programmes regardless of their size or the record of the authority involved. Local authorities' ability to use capital funds is limited. And their effectiveness in maintaining their local housing stock, schools and roads in sound condition is questioned by a number of independent experts.

(b) Local accountability can be blurred. For example, if local housing conditions for a local authority tenant are unsatisfactory (as is too often the case at present) it is not at all clear under the present arrangements who is accountable for this situation. A local authority with significant capital receipts that remain unspent could argue that responsibility rests with central government, which is in effect preventing the authority from undertaking the necessary investments in the interests of national macro-economic strategy.

(c) A longer-term central government perspective is notable for its absence. The history of capital expenditure controls over the past several years has been of short-term changes generally made to meet the requirements caused by an annual public expenditure system. The effect of reductions in programmes imposed at short notice has already been discussed. The Commission's survey shows that the planning horizon for both revenue and capital expenditure has shortened in the last few years.

(d) There are few positive incentives to encourage authorities to do more to help themselves e.g. by disposal of under-utilised capital assets, improving operating efficiency and increasing charges for local services. Indeed, there are now incentives towards uneconomic behaviour, in the form of the need to "spend" before the end of the financial year.

(e) Flexibility is more limited than it was in spite of the introduction of a 10% end of year carry over facility. The 1980 Act introduced more limitations on local authorities, most notably on their ability to fund expanded capital programmes from capital receipts or revenue.

98. If no changes are made to the present systems for financing local government – so that local accountability remains weak and GREs and grant distribution arrangements are still open to serious challenge – the weaknesses inherent in the present system described in the two preceding chapters would remain as serious obstacles to securing local economy, efficiency and effectiveness. In addition, assuming that the government is not willing to see expenditure allocations increased, overspendings are still likely and the level of capital expenditure will decline sharply. At the same

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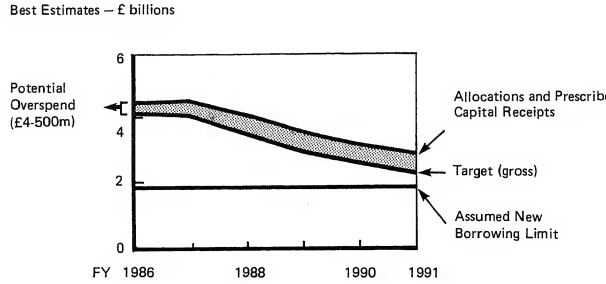
Exhibit 16 *ILLUSTRATIVE*

PROJECTED CAPITAL PROGRAMME UNDER EXISTING CONTROL SYSTEM



Source: Study Team Projection
See Appendix E for details

time, authorities will have less incentive to sell under-utilised assets. The figures below and in Exhibit 16 set out the study team's best estimate of future capital expenditure levels, assuming no changes in the control régime. It may be regarded as a "base case" and it assumes that cash limit continues at the 1985–86 level. [Cmnd no. 9428 forecasts a rise in local authority gross domestic fixed capital formation after FY 1986. But this of itself does not imply an increase to the cash limit]. Appendix E provides the detailed assumptions.

Table 17: LA CAPITAL EXPENDITURE FORECASTS
£million – best estimates

	FY 1984	1985	1986	1987	1988	1989	1990
Expenditure (gross)	£5,547m	5,250	4,348	4,415	4,042	3,628	3,285
Overspend on likely "targets"	368	800	298	365	522	578	535

Government will have to reduce the prescribed percentages further each year if it is to enforce control and this will reduce capital expenditure even more.

99. This analysis suggests that under the base case, capital expenditure will decline to not much more than £3 billion a year within five years; yet government targets for expenditure will continue to be exceeded by perhaps £400–500 million a year. It is little comfort that the present situation was not caused by the capital control system itself but (at least in some cases) by authorities' inability or unwillingness to improve their operating efficiency and to maintain their capital stock in sound condition. Whatever the background, the base case will involve a further rundown in capital assets.

100. The Commission does not accept this unattractive prospect as inevitable. But it is clear that more than marginal adjustments to the present arrangements will be needed if the underlying problems causing the present waste and inefficiency are to be addressed. Specifically, the

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following requirements basic to the economy, efficiency and effectiveness of local capital expenditure programmes need to be reflected in a new approach:

(i) A 3–5 year planning horizon for capital, so that programmes and projects are not subject to abrupt changes and the year-end 'rush to spend'.

(ii) Adequate provision for depreciation and replenishment of fixed assets in accounting treatment and spending programmes.

(iii) Encouragement to authorities to do more for themselves to fund their capital programmes and to rely less on new borrowing as a source of capital finance.

(iv) Minimal central involvement in the details of local programmes and projects. Unless projects are large (i.e. costing over £5 million, say) and/or cannot be funded internally, there seems little case for mandatory project controls.

(v) Continued incentives to authorities to dispose of under-utilised assets – even though special arrangements may be needed to deal with the problem of the 'over-hanging' £5 billion of past capital receipts.

(vi) Simplification of the system, in particular to avoid the need to distinguish between revenue and capital expenditure for control purposes. Revenue and capital are obviously inter-related and authorities face a choice between them (i.e. higher capital costs now, lower revenue costs later; less capital investment now, higher revenue expenditure later). This calls into question any system that seeks to control the two forms of expenditure separately. The present arrangements are a recipe for unproductive 'creative accounting'.

101. It will not be easy to reconcile these requirements with central government desire to control, simultaneously but separately, authorities' annual revenue and capital expenditure and new external borrowing levels. It may be necessary to give up some of the present controls to solve the serious problems caused by the present systems. The risks involved may be judged acceptable given the costs of doing nothing. The current very complex arrangements inevitably result in weak local accountability without delivering the desired controls. They hold the near-certain prospect of continued waste and inefficiency on an unacceptable scale as well as of continued overspending against government targets and a sharp decline in capital investment from over £5.5 billion now to around £3.3 billion before the end of the decade.

102. As in the earlier case of its report on the block grant distribution system, the Commission and its officers are ready to contribute towards the continuing discussions of possible solutions to the problems which this report has described.

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Appendix A

OUTLINE OF PRESENT SYSTEM OF CAPITAL CONTROLS

1. This appendix describes the current system of capital controls in local government and makes appropriate references to the one it replaced.

2. The *Local Government Planning and Land Act* 1980 introduced important changes in the method by which the central government exercises control over local authority capital expenditure. Under the provisions of the Act and subsequent regulations issued by the Minister, the government is able to control the actual capital expenditure of individual local authorities.

PRE-APRIL 1981

3. Prior to the legislation which came into force on April 1, 1981, local authority capital spending was controlled mainly by means of loan sanctions. Before 1971 a local authority had to obtain a loan sanction for any capital expenditure which it proposed to meet by way of raising a loan, and although there were powers to meet capital expenditure from capital receipts and revenue contributions and subject to certain limits from capital and repairs and renewal funds, this was in practice an effective method of control as the bulk of local government capital expenditure was financed from loans.

4. This system was changed to some extent with effect from April 1, 1971 in that new arrangements categorised capital expenditure into three classes:

(a) Key sector, which like the former system, still required specific approval and which included major services such as education, housing and police.

(b) Subsidiary sector, which included expenditure on land for key sector projects, expenditure on slum clearance and housing renovation grants and for which general consent to borrow was given by means of circulars.

(c) Locally determined sector, which included all capital schemes not falling within the other two sectors. To cover this sector a block borrowing approval was allocated to local authorities and all capital expenditure not financed by other means (e.g. from capital receipts, revenue contributions, capital funds, repairs and renewals funds or capital grants) had to be met from this allocation. In the shire counties the allocations between the individual county council and district councils were made by co-ordinating committees of all authorities within each county. There was a 10% flexibility which could be brought or carried forward each year and individual local authorities could transfer borrowing allocations to and from each other. Within this allocation each local authority was free to determine its own spending on individual schemes which fell within this sector.

POST 1981

5. With effect from April 1, 1981, the provisions of the *Local Government Planning and Land Act* 1980 came into force and applied to all local authorities. These provisions apply equally to England and Wales although there are slight differences in the administrative procedures in Wales. The following paragraphs of this appendix describe the present situation under the provisions of the Act and subsequent statutory instruments and outline the method of control of local authority capital expenditure by the central government.

6. The Act uses the term 'prescribed expenditure' to define expenditure which is regarded as capital expenditure for the purposes of the Act. Paragraph 1 of Schedule 12 lists prescribed expenditure as follows:

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(a) The acquisition of land, including buildings and structures on land;
(b) The acquisition of vehicles and vessels and of movable and immovable plant, machinery and apparatus;
(c) The reclamation, improvement or laying-out of land;
(d) The construction, preparation, conversion, improvement, renewal or replacement of buildings and structures;
(e) The repair and maintenance (if financed by borrowing)
  (i) of land (including dwelling-houses and other buildings) held under Part V of the *Housing Act* 1957, and
  (ii) of dwelling-houses held otherwise than under that part of the Act;
(f) The renewal or replacement of vehicles and vessels and the installation, renewal or replacement of movable and immovable plant, machinery and apparatus;
(g) The making of grants and advances of a capital nature other than grants and advances to local authorities or Passenger Transport Executives.

7. For the purpose of the Act the expenditure of Passenger Transport Executives is regarded as expenditure of their appropriate local authority.

8. Investments of superannuation funds are excluded from the definition of prescribed expenditure under the Act.

9. Paragraph 4 of Schedule 12 permits the Secretary of State to make regulations providing that certain types of expenditure shall not be prescribed expenditure. These are contained in The Local Government (Prescribed Expenditure) Regulations 1983 SI No 296. Such exemptions are consolidated and summarised in paragraph 3 of Circular 9/83 (as amended by Circular 6/84 and the 1984 Regulations) and include the following:

(a) Expenditure on the police, probation and magistrate court services on the Central Criminal Court, insofar as it is caught by Section 71 of the 1980 Act, since such expenditure is separately controlled by the Home Office;
(b) Expenditure on the acquisition of vehicles, vessels, plant or machinery by leasing where the contract does not include any provision for the asset to become the property of the local authority;
(c) Expenditure of the acquisition of a leasehold interest:
  – of 20 years or less (including any provisions for renewal) in land or buildings, except where a permanent building will be erected at the request of the authority;
  – of more than 20 years commencing on the expiry of a leasehold interest of 20 years or less acquired prior to April 1, 1980;
(d) Expenditure on the acquisition of land or buildings under any contract entered into before April 1, 1980;
(e) Expenditure on road schemes which are subject to a 100% grant from the Department of Transport;
(f) Expenditure by county councils on roads for new towns: Circular 6/84 extends this exemption to all contributions towards costs of new towns or the New Town Commission.
(g) Any payment by an authority to a water authority so far as the payment is met by a grant to the authority from the Land Settlement Association Limited;
(h) Expenditure which is met by payments made under insurance claims or out of an authority's own insurance or contingency fund;
(i) Expenditure on minor highway improvements;
(j) Expenditure on capital grants and advances to the private owners of historic buildings, to the extent that the expenditure is met from grants or advances made by the Secretary of State under Section 4

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or 6 of the *Historic Buildings and Ancient Monuments Act* 1953 and Section 10 or 10b of the *Town and Country Planning (Amendment) Act* 1972;

(k) Expenditure by the Common Council of the City of London from the Bridge House Estates: and expenditure from City's Cash, so far as the expenditure is not made by the City of London as a local authority, police authority or port health authority;

(l) Expenditure on loans made by an authority to its officers for the purchase of vehicles where the authority determines that an officer's use of a car is essential for the discharge of official duties; and

(m) Expenditure incurred on certain transfers of assets from new town development corporations or the New Towns Commission, in order to facilitate transfers under the terms of packages now being agreed within guidelines drawn up by the Secretary of State.

10. The regulations also provide that expenditure in connection with the acquisition, renewal or replacement of vehicles, vessels, plant, machinery or apparatus is not prescribed expenditure if it is less than £6,000.

11. There is, however, no hard and fast distinction between capital and revenue expenditure. Authorities which have previously treated small items of expenditure as running expenses rather than capital – and did not include them in their Capital Payments Return for previous years – may continue to treat such expenditure as revenue and not as prescribed expenditure.

Method of Control

12. Under the terms of the 1980 Act the previous method of controlling capital expenditure by means of loan sanctions was replaced by a system of expenditure allocations which limit the amount of capital expenditure which can be made by any individual local authority in any year. Thus the emphasis of control has been switched from that of the starting time of a project ('starts') and its associated borrowing power to one of controlling the amount spent within a given financial year (cash) however financed and to a notional amount representing the value of leased assets.

13. The allocations are made by the various central government departments according to their national responsibility for different services carried out by local authorities and are in separate blocks for education, personal social services, transport, housing and other services. As from April 1, 1984, a new urban aid block has been established to cover expenditure on derelict land and the urban programme which was formerly part of other services. The block allocations are determined by relevant departments after examining information gathered from local authorities.

14. The other services block allocation is made by the Department of the Environment. The Department decides on the amount of the total allocation and then deducts amounts for projects of regional or national importance and for any other sums allocated directly to individual local authorities. Examples of schemes of national or regional importance are the Thames Barrier and the Barbican Arts Centre; whilst examples of direct allocation to individual authorities for particular schemes are projects relating to urban programmes, and derelict land (up to March 31, 1984), coast protection, sea defences and major airport works. The central departments have powers to direct that part of an allocation can only be used for a project of national or regional importance.

15. After deducting these amounts, the remainder of the other services block is available for distribution to individual local authorities and this has usually been done by first allocating the amount between the various classes of local authorities and then to individual authorities on the basis of recommendations of the different local authority associations.

16. Each department will give authorities indications of expenditure

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allocations for future years wherever this is possible. However, such indications cannot be binding on the departments. In practice this has been implemented by guaranteeing 80% and 70% in the second and third years respectively.

17. In spite of the fact that these allocations are made in six blocks, the regulations offer local authorities flexibility. Firstly, virement is permitted between the various blocks thus allowing local authorities to determine their own priorities within the total limit. Secondly, authorities are allowed a further 10% as tolerance above their allocation. Circular 9/83 stated that this tolerance must be justified either from unused allocations from the previous year or by anticipation from the next year. The Department has now accepted, following a recent Counsel's Opinion, that the wording of Section 72 (8) of the 1980 Act is that the requirement for the use of tolerance to be justified as above, is brought into play only where the amount of an authority's prescribed expenditure in any year exceeds its allocation including supplementary allocations and those issued in respect of trading profits – and the prescribed proportion of net capital receipts. It follows that where an authority spends less than that total, using as a resource cover a mixture of allocations, 10% tolerance and possible receipts (but reserving a part of the prescribed proportion of receipts at least equal to the use made of the 10% tolerance), then the use of that tolerance does not affect the next year's allocation, even if there is no underspend in the previous year. For the time being the Department has agreed to accept this interpretation (formalised, in Statutory Instrument No. 23 and set out in Circular 6/84); but it warns that, depending on the use which authorities make of this provision, the Secretary of State may wish to find an opportunity for amending legislation.

18. In addition, net capital receipts or a proportion as may be prescribed and profits from trading undertaking may be used to supplement the total allocation. Local authorities are also able to transfer any part of their allocations to other local authorities.

19. A local authority's prescribed expenditure limit is therefore calculated as follows:

The total of its six block allocations plus or minus up to a maximum of 10% for tolerance between years;
Allocations transferred from (or to) any other local authority;
Allocations made direct to the local authority for specified projects;
Net capital receipts (or the prescribed proportion);
Profits of trading undertakings.

20. There are provisions under the 1980 Act empowering a Minister to withdraw an allocation provided that it relates to payments that the local authority has not made. It may not, however, be withdrawn if it relates to payments which the local authority is liable to make under a binding contract.

21. In addition to controlling local authority capital expenditure by means of prescribed expenditure limits there are further specific project controls in education, and housing and under the urban programme where many schemes need approval within criteria determined by the central government departments concerned.

Capital Receipts

22. As already noted, net capital receipts and profits from trading undertakings can be used to enhance the total of a local authority's permitted prescribed expenditure.

Under Section 75 of the 1980 Act a local authority may count as capital receipts:

(a) Sums received before April 1981 in respect of disposals of land and

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other assets and the repayment of them of grants and advances of a capital nature, but only to the extent that any such receipts were not spent by the authority for any purpose before that date;

(b) Similar sums received on or after April 1, 1981;

(c) Amounts calculated in accordance with Sections 75 (4) and 80 of the 1980 Act in relation to the disposal or termination on or after April 1, 1981 of certain non-freehold interests in land;

(d) Sums classified as capital receipts by virtue of regulations under Section 75 are set out in Circular 9/83 paragraph 26c. This list includes, for example;
- the net proceeds of lotteries
- gifts
- grants of a capital nature by specified centrally funded bodies and nationalised industries.

23. However, there are limitations on the proportion of some capital receipts which can be used to supplement allocations and these have been specified by regulations and in circulars.

24. The 1983 regulations summarised the position at that time as follows:

(a) Housing services:
- 50% of receipts from sales of dwellings;
- 50% of repayments of principal and redemptions of advances for house purchase and improvement;
- 1% of repayment of loans to housing associations; and
- 100% of all other housing capital receipts.

The 1984 regulations have reduced the 50% to 40% for the first two categories above.

(b) Non-housing services:
- 50% of receipts from disposals of land (including buildings), vehicles, vessels and plant;
- 50% of repayments of grants and advances of a capital nature.

(c) Other receipts: 100% of all items which would not otherwise be classified as capital receipts except for these regulations and which are set out in Circular 9/83 paragraph 26c e.g. net proceeds of lotteries.

25. Although the prescribed proportion applies to all receipts whether arising before April 1, 1983 or not, the Secretary of State decided that he would not issue a direction under Section 79 in respect of any greater use during 1983–84 of non-housing receipts accruing before April 1, 1983.

26. The 'cascade principle'. DOE Circular 9/83 clarified the way in which the prescribed proportion of capital receipt is to be calculated. Because it applies to the net capital receipts of an authority and is to be recalculated annually it means that an authority is not restricted for all time to applying a given percentage. Thus, if in the case of a prescribed proportion of 50% an authority applies that percentage in the first year it may then apply a further 50% of what remains in the following year; and so on. This is known as the 'cascade principle'.

27. Notional capital receipts. The Act and subsequent regulations have also introduced the concept of notional capital receipt which may be regarded as creating spending power (but not cash) in the same way as ordinary receipts. Such receipts arise from the disposal of leasehold interests, but in the case of disposals for not more than 20 years only to the extent that prescribed expenditure has been incurred.

28. Profits of trading undertakings. These are described in Section 72 (4) of the Act and are essentially the commercial activities of an authority. Therefore, these profits should be determined so that they reflect a true and fair view of the financial result of the particular trading undertaking in the

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year and should be calculated on a current cost accounting basis for prescribed expenditure purposes, and each trading undertaking should be regarded as if it were a separate business entity. Paragraph 33 of Circular 14/81 sets out detailed guidelines to be used in assessing the profit of a trading undertaking and in practice this generally means that a local authority will need to keep separate memorandum accounts for prescribed expenditure profit calculations.

29. Section 72(4) of the Act gives examples but does not define activities which are to be regarded as trading undertakings and the amount equal to the profits of any trading undertaking, calculated on the prescribed basis, may be used for that year to supplement the prescribed expenditure allocation of a local authority. Any capital expenditure made by the trading undertaking counts against the prescribed expenditure allocation.

Monitoring

30. The capital expenditure of individual local authorities is monitored by the Department of the Environment by means of a quarterly Capital Payments Return which has to be completed by each local authority. If it appears to the Department that a particular local authority is likely to overspend its allocation, it consults the local authority in order to ascertain the exact position to establish whether there is likely to be an overspending in the year. If the Secretary of State for the Environment considers that a local authority has failed or is likely to fail to keep within its allocation ceiling he may issue a *direction* to the effect that the local authority should not, without his consent:

(a) make any further payments which could lead to the ceiling being overspent;
(b) enter into any contract for new work or undertake such work above a specified cost, and
(c) enter into any contract above a specified amount.

Any overspending in itself is not 'ultra vires' but the contravention of a *direction* is.

Borrowing Controls

31. As shown in this appendix the emphasis of central government control over local authority capital expenditure has changed to the control of actual expenditure rather than of loan sanctions. However, local authorities still need to obtain permission before they are able to finance any capital expenditure by borrowing.

32. There is a general borrowing consent to cover the amount of the total capital expenditure contained in the expenditure blocks issued by the central government departments, subject to certain conditions, and the maximum load periods for various types of capital expenditure are laid down by Circulars.

33. In order to calculate its maximum permitted borrowing in any year a local authority adjusts the total of all its block allocations by adding or deducting allocations transferred from or to other local authorities and allocations enhanced by the tolerance regulations. It must also deduct the amount of any capital grants from either the central government or the EEC which have been used to finance any of its prescribed expenditure.

34. Local authorities must also comply with the specific conditions in respect of certain housing projects in order to comply with the terms of the general borrowing consent. In addition, housing authorities may not borrow to finance capital expenditure on municipalisation (except for certain exempted categories) or for housing land purchase unless the approval of the Secretary of State is first obtained.

Financing Innovations

35. During the years immediately preceeding the present system, local authorities and financial institutions had developed innovative ways of

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financing capital expenditure. These were largely designed to circumvent the borrowing regulations, or to secure for local authorities advantages which they were not entitled to in their own right. The most important of these were:

(a) Lease/lease-back arrangements whereby a local authority leased a completed building built by another organisation on land leased to that organisation by the authority;
(b) Covenant or deferred purchase schemes whereby the local authority undertook to apply for a development over an extended period without the formality of a lease or loan; and
(c) Leasing of plant and equipment to enable authorities to take advantage of tax allowances through effectively reduced rates of interest.

36. All these methods of financing are affected by Section 80 of the 1980 Act. So far as leasing is concerned, the general position is that the market value of the asset will count against expenditure as though it had been purchased outright. This provision has effectively ruled out lease/lease-back arrangements but there are exemptions within the regulations which still provide useful additions to prescribed expenditure limits, such as leases for less than 20 years or leases of plant, equipment and vehicles.

37. Large items of fixed plant continue to be leased because of the benefits of capital allowances under Section 64/11 of the *Finance Act* 1980. The total of such leases would normally be counted as prescribed expenditure in the year in which the lease is executed, but if it can be shown that the plant can never become the property of the local authority, such expenditure will not count.

38. The position of deferred schemes is unambiguously set out in Circular 9/83. For all schemes entered into after March 31 1981, the full amount of each payment (principal and interest) must be counted as prescribed expenditure in the year in which the payment is made. A recent innovation, not anticipated in the regulation, effectively avoids the interest from being counted as prescribed expenditure by transferring it to a loan raised against the prescribed expenditure.

39. The creation or support of a private company offers local authorities an effective way to realise capital schemes outside the regulations. However, their application is limited, complex and costly, and consequently this route has so far been used on few occasions.

* * *

40. *Postscript*: As late as March 1984, the government was still anticipating that the cash limit for 1983–84 would be underspent and had increased the allocations for 1984–85 by 2% accordingly. It later became apparent that 1983–84 expenditure was well in excess of the cash limit. Furthermore, on the basis of local authorities' returns for 1984–85 DOE concluded that government's gross capital expenditure targets for the current year would be exceeded. Consequently, the Secretary of State wrote to all authorities in July 1984 asking them to restrict their expenditure and commitments to the year's allocation, together with the prescribed proportion of receipts arising in 1984–85 only. Local authorities were also asked to complete returns showing the level of expenditure and unavoidable commitments together with the total of capital receipts estimated to accrue in 1984–85.

41. On the basis of the information contained in these returns the Secretary of State estimated that the overspend during 1984–85 would be £650m but that he was not proposing to take any further action during that

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year. However, appropriate adjustments have been made for 1985–86 and include a reduction of the prescribed proportion of capital receipts to 20% and 30% for major proportion of housing and non-housing receipts respectively, a holdback of allocations to compensate for the use of accumulated receipts, provision for additional allocations of 5% of basic allocations for authorities complying with the restrictions in this year; but continuing with 100% for receipts arising from low cost home ownership schemes.

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Appendix B

RESULTS OF FIELDWORK ENQUIRIES

During the fieldwork for the study, 20 authorities were visited and details were obtained on:

1. The adequacy of capital allocations, when compared with the original bids.
2. Problems encountered with the present system.
3. The extent to which the flexibility inherent in the system is used.
4. Impact of the new system on local plans and priorities.
5. Level of preparedness to implement capital programmes, compared with the situation under the former system.
6. Delays, if any, in obtaining project approval.
7. Longer-term effects of the new controls, as perceived by senior officers.
8. Effect of the block grant regime on capital projects and programmes.
9. Local views on the new system.

This appendix summarises the results of the fieldwork.

Q1. SYSTEM ADEQUACY

Bids and Allocations 1981–82 to 1984–85 in each authority are shown below (in £million, cash) for each allocation 'block' separately: Education, Personal Social Services, Transport, Housing, Other Services, Urban Programme (inc. derelict land).

Education

Authority No.	1981/82		1982/83		1983/84		1984/85	
	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.
3	1.5	.9	2.4	.7	2.4	1.6	1.7	.8
4	.5	.6	.2	.9	1.4	.9	2.7	1.0
5	1.6	1.8	1.5	1.5	1.5	1.4	1.8	1.2
6	2.1	2.0	2.3	2.1	2.4	3.1	3.7	3.3
7	2.1	2.1	1.5	1.5	3.7	1.9	3.8	1.7
8	3.5	3.5	2.6	2.6	2.5	2.5	2.0	2.0
11	9.5	9.5	7.2	5.7	4.7	4.0	7.5	3.6
12	9.7	8.7	13.7	8.5	10.5	6.8	10.4	6.5
13	1.4	1.4	1.9	1.5	2.3	2.0	2.8	1.4
14	2.3	2.3	2.3	2.3	3.7	3.7	7.5	5.0
	34.2	32.8	35.6	27.3	35.1	27.9	43.9	26.5
Actual Exp.		30.5		35.5		32.7		

In several authorities details on bids in the first two years were not available. In these cases the same amount as the allocation has been assumed.

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Personal Social Services

Authority No.	1981/82		1982/83		1983/84		1984/85	
	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.
1	1.2	.9	1.4	1.6	1.2	1.3	1.7	1.1
2	.4	.4	.5	.6	1.2	.6	1.4	1.2
3	.4	.4	.6	.6	.3	.3	.5	.5
4	.4	.5	.4	.5	.4	.4	.9	.5
5	.3	.6	.5	.6	.7	.7	.8	.6
6	.6	.6	.7	.7	.9	.9	1.1	.8
7	.3	.4	.4	.4	.7	.7	.7	.7
8	.3	.3	.4	.6	.7	.7	.6	.6
11	1.0	1.1	.9	1.0	1.6	1.6	2.4	1.9
12	1.3	1.7	1.7	1.9	2.0	2.0	2.5	2.4
13	.8	1.0	.4	.6	.7	1.0	1.7	1.5
14	.1	.2	.4	.4	.2	.1	.5	.5
	7.1	8.1	8.3	9.5	10.6	10.3	14.8	12.3
Actual Exp.		8.2		8.3		8.8		

Transport

Authority No.	1981/82		1982/83		1983/84		1984/85	
	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.
9	23.3	20.4	30.9	27.9	42.2	39.4	51.0	35.9
10	20.8	19.3	25.8	19.6	31.1	24.7	36.1	22.0
11	6.0	4.8	7.2	6.2	14.1	8.5	13.1	9.5
12	4.8	4.1	5.1	4.4	5.5	5.4	8.1	6.4
13	2.0	2.0	3.1	3.7	5.8	5.0	1.7	1.9
14	3.8	5.1	5.0	5.8	7.3	7.3	9.6	8.5
	60.7	55.7	77.1	67.6	106.0	90.3	119.6	84.2
Actual Exp.		55.6		71.2		75.9		

Housing

Authority No.	1981/82		1982/83		1983/84		1984/85	
	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.	Bid	Alloc.
1	24.9	17.4	23.2	25.7	30.2	29.7	37.4	18.8
2	60.6	34.6	64.5	37.0	76.2	35.1	72.8	34.4
3	12.7	5.3	8.1	5.5	13.1	5.0	12.5	4.8
4	8.0	6.5	4.8	5.1	9.2	6.9	19.7	3.7
5	17.2	11.2	12.6	13.6	17.1	14.4	30.6	10.0
6	23.8	12.7	17.7	15.2	25.0	14.7	33.9	12.8
7	11.9	11.9	11.8	11.8	19.9	13.1	26.4	12.5
8	14.4	11.8	10.5	10.9	18.5	9.3	17.4	9.3
15	4.4	2.8	5.2	3.0	5.5	3.3	7.2	3.0
16	2.5	2.0	2.0	2.0	2.6	2.1	6.0	2.1
17	12.5	6.7	12.8	9.1	16.8	8.5	16.5	7.6
19	6.9	2.2	8.4	2.8	5.7	2.7	10.5	2.7
20	3.9	2.5	3.5	2.4	4.0	2.3	2.8	1.7
	203.7	127.6	185.1	144.1	243.8	147.1	293.7	123.4
Actual Exp.		137.8		175.1		219.1		138.0

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Other Services

Authority No.	1981/82		1982/83		1983/84		1984/85	
	Prog.	Alloc.	Prog.	Alloc.	Prog.	Alloc.	Prog.	Alloc.
1	4.5	1.3	4.7	4.7	2.7	1.1	6.2	1.0
2	1.4	.9	2.1	.9	7.6	.9	9.6	1.1
3	2.7	1.1	2.7	1.5	3.4	1.2	4.2	1.1
4	1.3	1.0	1.7	1.2	1.4	1.0	3.7	1.2
5	3.0	1.1	5.0	1.0	5.0	.9	4.0	1.1
6	4.3*	2.2	4.2	2.0	6.4	1.8	5.8	1.6
7	3.8*	1.8	2.6	1.2	4.6	1.3	3.6	1.0
8	3.0	1.4	4.7	1.2	8.2	1.3	5.7	1.6
9	10.0	7.4	15.0	5.0	8.9	3.5	8.6	3.3
10	9.3	6.6	10.6	3.7	14.7	3.9	14.8	3.8
11	3.2	2.0	2.4	1.3	3.3	1.3	2.8	1.3
12	10.8	3.2	8.4	5.7	13.5	4.0	13.1	4.0
13	4.1	1.7	3.2	1.1	3.7	1.1	3.2	1.1
14	4.2*	2.3	3.2	1.5	5.7	1.6	5.8	1.6
15	.5	.2	1.2	.3	1.9	.5	1.7	.6
16	.4	.2	.3	.3	.3	.2	.8	.3
17	1.5	.5	2.5	2.2	2.3	.7	2.6	.7
19	1.4	.5	.2	.2	2.0	.4	1.8	.4
20	1.3	.7	1.0	.6	1.3	.5	1.4	.5
	70.7	36.1	75.7	35.6	96.9	27.2	99.4	27.3
Actual Exp.		68.7		101.9		111.0		

* Authorities 6, 7 and 14 were unable to provide programme figures in which they could have confidence. Allocations have therefore been increased by the average percentage of programme over allocation for all other authorities.

Urban Programme inc. Derelict Land

Details of programmes were not generally available for these services in order to provide a reliable statement. The table is therefore restricted to allocations received. The information for 1984–85 is incomplete due to the continuous process of making urban programme allocations.

Authority No.	1981/82 £m	1982/83 £m	1983/84 £m	1984/85 £m
1	3.2	5.3	5.6	5.6
2	2.4	4.6	4.3	–
3	–	.2	–	–
5	.2	.5	.4	.3
6	3.0	6.8	5.6	4.4
7	.1	.6	.4	.7
9	15.0	31.1	27.6	10.7
10	.3	1.4	1.2	–
11	1.3	1.5	1.5	1.4
12	.6	1.2	1.9	1.9
13	–	.4	.3	.6
14	–	–	–	.1
15	–	.3	–	.1
17	.1	.1	–	–
18	2.3	2.9	5.0	5.0
	28.5	56.9	53.8	30.8

Expenditure included in other services above.

SUPPLEMENTARY QUESTION ON ADEQUACY

1 (a) **Aggregation of allocations for planning programmes.**

	No.
All added	9
All separate	5
Other combinations	6

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1 (b) **Method of distribution of other services block.**

	No.
Agree with present system	11
Disagree	7
Undecided	2

1 (c) **Trend of "other services" block.**

	No.
Authorities agreeing with trend towards more specific allocations	4
Disagreeing	11
No view	5

1 (d) **Home Office services.**

	No.
Should be included in current system	11
Should not	5
No view	4

1 (e) **Use of the 1982/83 November Allocation.**

Authority No.	Save Capital Receipts £m	Convert Deferred Pch £m	Non-Programmed Work £m	Priority Spending £m
1	3.5	–	1.0	4.0
2	–	–	–	14.8*
3	–	–	–	–
4	–	–	–	.3
5	–	–	–	–
6	.4	–	1.4	.3
7	–	5.8	.7	1.0
8	–	–	–	2.5
9	–	–	1.7	1.8
10	–	–	–	3.4
11	.9	–	1.5	1.5
12	1.3	–	–	–
13	–	–	–	.5
14	–	–	–	–
15	–	–	–	–
16	.1	–	.4	–
17	–	.3	1.3	.2
18	–	–	.6	.7
19	.1	–	–	.7
20	–	–	–	–
	6.3	6.1	8.6	31.1

* This sum which could be immediately spent was transferred to a local authority owned company.

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Q2. PROBLEMS

Authorities were asked to provide details of problems arising because of definition, technical, legal or operational difficulties. The individual replies are summarised below.

Authority

1 Complex, difficult to comprehend particularly by service departments. Too much emphasis on technical and financial issues at expense of service.

2 Partnership allocations are not known until long after accounts are closed. Rules very complex and still subject to legal interpretation. DOE does not reply to requests for additional borrowing approval. Capital receipts are hard to forecast. The emphasis on annual spending levels can distract attention from other issues.

3 Rules too complex and problems of interpretation admitted by DOE. Problems with financing non-prescribed expenditure. Prefer a control of payments.

4 When much of cashflow is outside control of authority a 10% tolerance is insufficient. Uncertainties and frequent changes in relation to capital receipts inhibit planning. Too many uncertainties in forecasting current level of receipts.

5 Difficulties of definition of certain items (e.g. repair and improvement work) of prescribed expenditure. Legal definition of tolerance and prescribed proportion leading to misunderstandings. Forecasting capital receipts difficult. Trading profit asset valuation problems. Serious problems of uncertainty caused by short planning horizons with long project timescales. Stop/go policy on housing.

6 Prescribed expenditure definitions, delays in clarifying tolerance rules, and problems forecasting current receipts. Increased administration.

7 Misunderstanding of rules governing trading profit (automatic borrowing approval), tolerance and mortgage repayments. Difficulty of forecasting capital receipts. Necessity of rushing through or deferment of payments in March.

8 Uncertainty on cascade principle and tolerance rules. The provision of yearly allocations does not help planning. Year-end spending can work against obtaining value for money.

9 Uncertainty because of interpretative problems of cascade rule, tolerance, and calculation of notional receipts. Great difficulty in forecasting level of current receipts. Increase in administration.

10 Emphasis now placed on the objective of forecasting allocations at the expense of other work.

11 Need to keep additional records of real prescribed expenditure, notional and real receipts and in connection with leasing and deferred purchase. Pressure not to use receipts to repay debt. Difficult to forecast current receipts. Controlling cash payments introduces unnecessary problem, particularly in relation to land.

12 Greater problems caused by uncertainty of meaning of key terms and therefore total spending power available. Difficult to harmonise payments and capital receipts. Change from starts to payments unwelcome.

13 Major difficulty with interpretation of tolerance rules. Consider changes from starts to payments as a retrograde step.

14 Request for voluntary restraint has caused confusion. Changed definitions have made control of notional receipts (e.g. repayment of advances and joint finance) particularly difficult. More administration required. Difficulties in forecasting receipts. Has accentuated problems caused by slippage.

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15 Problem of tolerance rules, forecasting receipts and lack of long-term planning.
16 Members and non-financial officers find logic of system hard to understand. Confusion of use of tolerance. More administration required.
17 Problem in forward planning when regulations regarding the use of capital receipts are constantly being changed.
18 Difficulty forecasting level of current receipts.
19 Impossible to rely on the value of current receipts. Capital planning extremely difficult with constant change of key rules.
20 Increased administration due to need to keep duplicate records. Uncertainty of capital receipts.

Q3. FLEXIBILITY: **Transfer of Allocations between Authorities. £m**

	1981/82				1982/83				1983/84			
	IN		OUT		IN		OUT		IN		OUT	
Authority No.	Non Rep	Repay	Non Rep	Repay	Non Rep	Repay	Non Rep	Repay	Non Rep	Repay	Non Rep	Repay
1		.1			1.7			.1				
2	1.0				.9							
3	.5							.4				
4				.1	.2	.1		1.2		.9		
5	.2			.3		.3			.8*			
6	1.3									2.0		
8						.5						.3
9					1.0							
10						.3	.3					.3
11			.1	.7		.7	.3		.1		.4	
12		.8			.1	.6	.1	.8			.1	.6
13											.2	
14											.6	
17					.1		.1					
18					.5							
	3.0	.9	.1	1.1	4.5	2.5	.8	2.5	.9	2.9	1.3	1.2

* Borrowing approval only.
Authorities 7, 15, 16, 19, 20. No transfers.

3 (a) **Application lost £m**

No.	1981/82	1982/83	1983/84
5 authorities	1.4	.8	.6

3 (b) **Use of inter-service flexibility**

Consider that anything other than marginal flexibility would be penalised by adjustment to future allocations	13
Do not consider	2
Uncertain	3

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3 (c) **Creation of additional capital receipts**

Authorities actively considering further disposal of assets, such as housing advances, industrial estates etc	15
Not actively considering	5

Prescribed Expenditure and Enhancements

Authority No.	PRESCRIBED PROPORTION OF SPENDING POWER AND ACTUAL EXPENDITURE £M											
	1981/82				1982/83				1983/84			
	Alloc.	Enhan.	Total	Spend	Alloc.	Enhan.	Total	Spend	Alloc.	Enhan.	Total	Spend
1	20.8	17.2	38.0	26.9	33.8	22.0	55.8	34.2	35.7	21.0	56.7	41.1
2	38.6	8.9	47.5	42.1	59.9	11.9	71.8	70.0	41.9	7.6	49.5	52.9*
3	9.5	19.6	29.1	13.5	11.7	17.6	29.3	12.4	10.4	18.8	29.2	13.5
4	9.3	9.4	18.7	8.8	9.2	12.7	21.9	9.1	11.2	17.7	28.9	13.0
5	14.9	8.8	23.7	13.2	17.5	21.4	38.9	19.5	18.0	23.0	41.0	30.0
6	20.4	14.9	35.3	21.9	27.0	24.5	51.5	30.2	26.1	23.4	49.5	39.9
7	18.6	8.2	26.8	19.4	18.2	10.1	28.3	22.3	21.2	13.3	34.5	30.0
8	16.9	4.7	21.6	16.4	20.2	10.2	30.4	25.3	18.4	10.2	28.6	24.8
9	43.3	10.1	53.4	41.8	63.9	13.8	77.7	66.8	71.7	15.0	86.7	71.9
10	26.2	8.3	34.5	24.8	28.1	9.6	37.7	26.5	29.7	6.3	36.0	30.8
11	17.4	2.9	20.3	14.9	17.5	4.8	22.3	19.4	15.4	2.6	18.0	17.2
12	17.6	13.3	30.9	19.1	20.5	13.5	34.0	20.9	18.3	8.7	27.0	22.6
13	6.1	4.6	10.7	7.0	7.2	6.9	14.1	8.4	9.5	4.4	13.9	10.4
14	9.8	12.1	21.9	10.5	9.9	14.8	24.7	11.9	12.6	10.5	23.1	11.0
15	3.1	3.2	6.3	4.6	3.3	6.9	10.2	5.5	3.7	6.5	10.2	6.6
16	2.2	2.5	4.7	2.2	2.9	4.1	7.0	2.9	2.9	4.2	7.1	3.7
17	7.3	3.4	10.7	7.7	11.4	10.1	21.5	12.0	9.6	14.6	24.2	16.1
18	7.0	3.3	10.3	6.2	10.5	5.1	15.6	14.0	12.2	8.1	20.3	11.8
19	2.7	11.1	13.8	4.7	3.0	17.7	20.7	5.8	3.1	31.3	34.4	10.0
20	3.3	2.7	6.0	3.0	3.0	2.5	5.5	2.9	2.8	2.3	5.1	3.7
TOTAL	295.0	169.2	464.2	308.7	378.7	240.2	618.9	420.0	374.4	249.5	623.9	461.0

*overspend against 1984/85

Notes: Enhancement is defined as:
Prescribed proportions of
- housing capital receipts
- non-housing capital receipts
- notional capital receipts

The amount of capital receipts available has been calculated as follows:
- in hand brought forward
- received during the year
- available (prescribed %)
- used
- in hand carried forward

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Non-Prescribed Expenditure

Authority No.	NON-PRESCRIBED AND OTHER CAPITAL EXPENDITURE £M											
	1981/82				1982/83				1983/84			
	De Minimus	Leasing	Other	Total	De Minimus	Leasing	Other	Total	De Minimus	Leasing	Other	Total
1	.1	–	2.8	2.9	.1	2.1	1.3	3.5	.1	.6	.7	1.4
2	.1	.8	.1	1.0	.1	1.5	.1	1.7	.4	2.9	.4	3.7
3	.1	.6	.5	1.2	.1	.5	1.1	1.7	.1	.4	1.3	1.8
4	.3	.5	.5	1.3	.3	.5	.7	1.5	.3	.5	.4	1.2
5	.1	.3	–	.4	.1	.5	–	.6	.1	.8	–	.9
6	.1	.6	–	.7	.1	2.0	–	2.1	.1	2.8	.8	3.7
7	.1	.8	.1	1.0	.1	.5	.1	.7	.1	.7	–	.8
8	.1	1.0	–	1.1	.1	.9	–	1.0	.1	.6	–	.7
9	1.2	8.8	–	10.0	1.4	18.0	–	19.4	1.3	13.2	–	14.5
10	.3	5.1	–	5.4	.8	6.8	–	7.6	.7	7.0	–	7.7
11	.3	.9	–	1.2	.5	.4	.2	1.1	.3	4.2	.5	5.0
12	2.0	1.7	–	3.7	2.2	2.4	–	4.6	2.1	3.3	–	5.4
13	.1	1.0	–	1.1	.1	1.0	–	1.1	.3	.6	–	.9
14	.8	–	.5	1.3	.8	–	.5	1.3	1.5	–	.5	2.0
15	.1	.1	–	.2	.1	.1	–	.2	.1	.1	–	.2
16	.1	–	–	.1	–	–	–	–	–	–	–	–
17	–	.1	–	.1	–	.1	–	.1	–	.1	–	.1
18	.1	.6	–	.7	.1	.6	–	.7	.1	.8	–	.9
19	.1	–	–	.1	.1	.1	–	.2	.1	.1	–	.2
20	–	.2	–	.2	–	–	–	–	–	.2	–	.2
TOTAL	6.1	23.1	4.5	33.7	7.1	38.0	4.0	49.1	7.8	38.9	4.6	51.3

Q4. PLANS AND PRIORITIES

The local authorities were asked to provide some evidence to see if the control system and associated flexibility still permitted them to embark on important capital schemes which, for this purpose, were defined as lasting for at least three years from the first contract payment to the last.

They were also asked to give some indication on the level of changes that take place and the reason for those changes. This was done by showing schemes which were originally planned but never (in the time scale) achieved and those schemes which were not in original plans but nevertheless realised. The principal reasons noted were:

	No. of Authorities
Failure to agree with third parties	1
Changes in priorities	7
Insufficient allocations	3
Ease of implementations	2
Additional allocations	5
Slippage	2
Additional receipts	1
Projects not ready	2
Revenue consequences	1

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Plans and Priorities

Auth. No.	Projects planned to last more than 36 months: 1981/82 No.	1981/82 Value £m	1982/83 No.	1982/83 Value £m	1983/84 No.	1983/84 Value £m	Projects planned for 1981/82 not started by end of 1982/83 No.	Value £m	Projects not in 1981/82 or 1982/83 estimates but started in 1982/83 No.	Value £m	Projects planned for 1982/83 not started by end of 1983/84 No.	Value £m	Projects not in 1982/83 or 1983/84 estimates and started in 1983/84 No.	Value £m
1														
2														
3	6	8.0	5	5.9	2	43.0								
4														
5	17	14.3	39	25.3	11	2.5	3	2.7	14	0.6	3	1.3	7	0.4
6														
7	–	–	2	5.1	3	40.0								
8	11	6.8	23	17.2	11	5.4	5	49.0	34	7.5	14	3.3	8	0.6
9	11	26.0	9	11.0	20	57.0								
10	–	–	–	–	–	–	21	1.7	40	2.8	19	1.3	14	1.0
11	2	3.1	3	8.1	4	14.3	7	3.0	7	1.3	4	5.0	2	0.3
12	22	13.8	19	6.8	26	12.6	6	4.1	7	0.8	2	0.1	9	0.4
13	3	2.7	–	–	3	1.2	4	0.8	21	2.4	4	0.5	23	1.2
14	–	–	1	1.7	2	14.7	2	1.2	–	–	–	–	–	–
15														
16	–	–	–	–	–	–	3	0.8	3	0.7	2	0.4	–	–
17	–	–	2	0.6	1	4.0	–	–	23	0.9	1	0.1	8	0.1
18														
19	–	–	–	–	1	4.5								
20	4	2.4	1	0.2	–	–								

Authorities 1, 2, 4, 6, 15 and 18 were not able to supply this information readily.

Q5. LEVEL OF PREPAREDNESS

Local authorities were asked to indicate if they were more or less well prepared to carry out capital programmes compared with the period prior to 1981–82. The replies are summarised below.

Authority No.	Land Acquisition	Policy Evaluation and Approval	Design etc.
1	Worse*	Same	Same
2	Same	Same	Same
3	Better	Better	Better
4	Same	Better**	Same
5	Worse***	Worse***	Worse***
6	Same	Same	Same
7	Same	Better**	Better**
8	Better**	Better	Better
9	Same	Same	Same
10	Same	Same	Same
11	Better*	Better	Better
12	Same	Better	Same
13	Same	Same	Same
14	Same	Same	Same
15	Same	Same	Better
16	Worse***	Same	Worse***
17	Worse	Same	Same
19	Same	Better**	Same
20	Same	Same	Same

* Change in local political control cited as reason.
** The discipline inherent in reduced resources/complex control system.
*** Uncertainties.

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Q6. PROJECT APPROVAL

Local authorities were asked if they had encountered delays or difficulties in the approval of individual schemes; whether the position was improving or worsening; and how they viewed the current system compared with the pre-1981–82 arrangements. The summarised replies are set out below.

Service	Significant Delays		Improving	Worsening	Compared with pre–1981/82	
	Yes	No			Better	Worse
Housing	5	5	2	1	7	1
Education	3	5	–	1	5	–
Urban Aid	6	4	2	2	4	2

Q7. LONGER-TERM EFFECT OF CONTROLS

Local authorities were asked to state if they thought the present system of capital control had had a harmful or beneficial effect on their authority since 1981. The main comments of authorities are summarised below.

1. New system allows greater scope for determining needs and priorities locally.
2. The system has caused the council to seek other means of finance for capital expenditure.
3. There have been no harmful effects in terms of capital expenditure and planning. However, as controls have become more complex a lot of effort has been wasted in interpreting changes to the system.
4. Beneficial, in that the authority is more cost conscious, more attentive to sale of under-utilised assets and cashflows. Harmful in their inability to predict even short-term levels of spending.
5. Harmful. An inefficient and wasteful system. Note housing moratorium 1980–81, booms of 1982–83 and 1983–84 and capital restraint 1984–85. Whilst some problems of definition and law are becoming clearer, the basic instability of the system and consequent rule changes are increasingly obvious.
6. The main problem is the level of resources available. The system is complex but does afford a degree of freedom which is welcome.
7. The method of control is not the significant factor but the level of expenditure which will be incurred. It is thought the government will be unlikely to make more resources available because of the freedom to choose priorities locally and this in turn may lead to further hypothecation.
8. In terms of planning, programming, monitoring and control, the system has had a beneficial effect since it reinforces the need for realism in these processes. Given that available resources will always fall short of the council's objectives, the system emphasizes the need to examine proposals and priorities carefully.
9. Generally harmful. The system does not enable long-term planning to be undertaken. Allocations are received too late. The uncertainties of the legislation have not been helpful. The late allocations in 1982–83 diverted attention from the existing programme.
10. The council has always worked within allocations on a year by year basis and has not been seriously harmed by the system.
11. The system has contributed to a tightening of control and monitoring of the progress of projects. While this has its positive aspects, it has involved a considerable diversion of management time into trying to fit capital payments into arbitrary time periods.
12. Whilst the new system has improved the discipline of control, the authority has been seriously harmed because of its relatively low level of saleable assets and the inability to increase capital expenditure from revenue.

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13. The authority has been able to 'manage' the weaknesses and deficiencies of the system because of the large amount of capital receipts held.

14. The system has heightened the awareness of members and officers to the importance of the management of capital projects. However, the short-term nature of the controls, their frequent revision and detailed nature, have all made for a great deal of uncertainty.

15. Shortage of capital resources has frustrated the council's objectives.

16. There has been a significant increase in uncertainty due to the late allocations and the level of capital receipts.

17. The changes in prescribed proportions of capital receipts and stop-go notices have meant that the greater freedom has been replaced by a system of short-term control of total expenditure. This has lead to wastage of resources when trying to formulate longer-term plans.

18. A system that promised freedom and flexibility has been undermined by subsequent changes and has seriously harmed central/local relations.

19. The main concern is the uncertainty over the level of future allocations and capital receipts availability.

Q8. EFFECT OF AND RELATIONSHIP WITH BLOCK GRANT REGIME

Local authorities were asked a series of questions relating to the connection between the two main elements of control. The replies are summarised below.

Question		YES	NO
1.	Are projects now designed with a view to minimising revenue consequences?	15	3
2.	Has there been a marked tendency to increase spending on schemes with relatively low revenue consequences (e.g. loans and grants) and to decrease spending on schemes with high maintenance and staffing costs?	6	12
3.	Is expenditure now being capitalised where it was formerly charged to revenue prior to 1981–82?	14	4
4.	Have categories of spending now been redefined as capital since 1981–82?	13	6

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Q9. NEEDS FOR CONTROLS

Local authorites were asked to state their view of the need for controls, improvements they would most like to see and the effect the abandonment of specific controls was most likely to have assuming all other factors remained unchanged. The replies are summarised below.

L.A.	Need for control	Principal improvement desired	Principal benefit from change	Effect on spending level
1	Some	Clarify, simplify and abandon proj. control	Switch spending from revenue to capital	
2	None			Increase spending 5% – 10%
3	Some	Simplify and give more certainty about level of future allocation	Reduced administration	None
4	Some	Earlier and more certain future allocations	Improve planning and implementation	Significant increase in improvement grants
5	Some	Indication of min and max allocations over 3 years	Improve planning less admin. and able to find better balance between revenue and capital	Overall by over 10% because of housing need
6	Some	Earlier and more certain notification and less 'panic' moves	Greater discretion	
7	Some	Increase certainty about level of spending and availability of capital receipts	Expansion of housing programme and urban aid	Over 10% in priority areas
8	Some	Simplify, allow full use of capital receipts	Freedom to choose funding method	Up to 5% increase
9	Some	Longer-term allocations and greater flexibility	Better planning	Little increase; because of revenue control
10	None	Earlier and more certain future allocations; less changes	None	None
11	None	Better method of distribution of allocations	Better planning	Increase by 0 – 5%
12	None	Increase in tolerance and use of other sources of finance	Increased freedom to determine priorities	Increase
13	None	Abandon restrictions on use of receipts	Better planning, less admin and manipulation	None
14	Some	Certain allocations for 3 years; fewer changes and abandon project control	Better planning Greater freedom	None
15	Some	Control borrowing only	Better planning greater discretion	None
16	None	Earlier and more certain allocations for 3 years	Increased choice	Housing 5% – 10%
17	Some	Move to 3 year allocations and less changes in capital receipts rules	Greater certainty and better planning	Housing over 10%
18	Some	Fewer changes and longer-term notifications	Better planning and change in emphasis to value for money	Housing 0 – 5%

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Appendix C

THE COST OF PROJECT DELAYS

Example 1: Secondary school reorganisation

A scheme to reorganise secondary schools costing £1 million in order to secure the closure of 1000 places. The following assumptions are made:

—The saving per place is estimated to be £230. This is taken from page 13 of the Audit Commission's report on non-teaching costs in secondary schools. This figure was based on the £100 quoted in the Circular 2/81 increased for inflation and interest savings generated by the sales of surplus land and buildings and reduced by an increase in the cost of home-to-school transport.

—Savings are achieved in the second year after completion; there are no savings in teaching costs.

—Extra design and administrative costs of 7% for one year delay.

—Loan charges at 11% for 30 years.

Table C-1 shows the cash flows at constant prices arising from the project.

Table C-1: PROJECTED CASH FLOWS
Secondary school example — £000

	Plan		Actual	
Year	Outflow (*loan charge*)	Inflow (*savings*)	Outflow (*loan charge*)	Inflow (*savings*)
1	£11.5		4.0	
2	69.0		19.6	
3	115.0		77.0	
4	115.0		123.1	
5	115.0	230.0	123.1	
6	115.0	230.0	123.1	230.0
	. . . Continuing for 30 years			

The net present value arising from the scheme is £206,000 less with a year's delay, using a 5% discount rate (and £158,000 using an 8% rate).

Example 2: Energy conservation

Energy conservation schemes can show dramatic savings in running expenses. After the second oil crisis a county council established an energy conservation unit. The basic investment programme is still not complete, even though most insulation schemes pay back within 3–5 years. The Department of Energy guidelines suggest that insulation schemes yield minimum savings of 15% of the cost of the primary fuel averaged over 2–3 years. Two recent schemes have worked out as follows:

1st School:	Cost of work plus admin (15%)	£560
	15% of oil heating account	£193
	Payback	35 months
2nd School:	Cost of work plus admin (15%)	£2055
	15% of gas and oil heating account	£455
	Payback	55 months

Actual savings used in the payback calculations exceeded the 15%.

Other schemes such as automatic light and heating controls have shown payback periods as short as 18 months. However, the council has still not been able to embark on an energy management system due to insufficient capital resources.

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Example 3: Housing

Because of the current large gap between interest rates and the rate of inflation the delay in a new building contract does save money even though the local authority may be incurring bed and breakfast for a small proportion of its clients. More importantly because of the combined effect of rent pooling and sub-economic rents every new house creates a substantial deficit on the Housing Revenue Account which is largely borne by the other tenants. Thus for example:

	£
Loan charges on house costing £30,000	3360
Allow for repairs, supervision and management	300
Annual cost	3660
Less rent	1000
Loss on HRA	2660

It is appreciated that this narrow view takes no account of the substantial social, psychological and indirect costs of inadequately housed people.

On the other hand delays in modernising and repair of existing properties can lead to significant rises in costs because of the exponential rate of decay and vandalism and damage. A recent example in a metropolitan district is not unique. In this case it was decided to completely vacate a 22 storey tower block because most tenants had already left, to totally remodernise the block into apartments for first-time buyers. The cost two years ago was estimated to be about £400,000.

The two-year delay has allowed the property to deteriorate rapidly and has provided many opportunities for vandalism so that refurbishment costs are now estimated to have increased to almost £2 million. Failure to take action on the deteriorating housing stock of the country will inevitably lead to more expenditure as buildings get beyond the point at which they can be modernised and new houses will have to be built.

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Appendix D

CAPITAL EXPENDITURE TRENDS

This appendix reproduces details of capital expenditure in England. The following tables are included:

D–1: Capital allocations by service and class of authority, FY 1982–86.

D–2: Gross capital expenditure by services, FY 1975–84.

D–3: Gross capital expenditure at 1980 prices, FY 1975–84.

D–4: Gross capital expenditure by class of authority, FY 1975–84.

D–5: Share of gross capital expenditure, FY 1976–83.

Table D-1: CAPITAL ALLOCATIONS
(i) By service, £million, England

FY	1982	1983	1984	1985	1986
Education	355	338	295	291	315
Personal Social Services	89	106	109	116	70
Transport	615	685	742	805	640
Housing	1796	2150	2173	1852	1600
Other	556	776	525	372	320
Urban	82	160	194	269	280
	3493	4215	4038	3705	3225

(ii) By class of authority, £million, England

Shire Counties	576	619	615	
Met Counties	208	221	254	
Met Districts	705	947	886	(not available until after
GLC	397	406	354	end of year because of late
Inner London	350	439	382	allocation of Urban
Outer London	269	308	296	Programme)
Shire Districts	988	1275	1251	
	3493	4215	4038	

Source: DOE

Table D-2: GROSS CAPITAL EXPENDITURE BREAKDOWN BY SERVICE
£million, England

Service	FY 1975	76	77	78	79	80	81	82	83	84
Education	423	474	450	388	363	412	521	426	476	534
Health and Social Services	70	79	67	52	63	80	101	96	98	121
Law, Order & Protective	61	86	93	85	84	89	97	110	140	144
Local Transport & Highways	359	423	402	354	370	444	564	543	622	719
Housing Advances, Grants & Non-HRA	930	660	535	491	539	696	602	541	759	1187
Local Environmental	323	397	390	357	436	555	705	632	904	957
Housing HRA	1516	1786	1854	1764	1767	1930	1741	1422	1725	1755
Trading	101	116	92	93	101	144	210	193	237	193
	3783	4021	3883	3584	3723	4350	4541	3963	4961	5610

Source: Local Government Financial Statistics FY 75–83
DOE provisional figures for FY 84 (with FY 83 used for GLC)

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Table D-3: GROSS CAPITAL EXPENDITURE BREAKDOWN BY SERVICE
£million at 1980 Prices, England

Service	FY 1975	76	77	78	79	80	81	82	83	84
Education	998	925	798	629	516	480	504	400	444	483
Health and Social Services	165	154	119	84	89	93	98	90	92	109
Law, Order & Protective	144	168	164	138	119	104	94	103	131	130
Local Transport & Highways	846	826	713	574	526	517	545	510	581	650
Housing Advances, Grants & Non-HRA	2193	1289	949	796	767	813	582	508	709	1073
Local Environmental	761	775	691	578	620	646	682	593	844	865
Housing HRA	3575	3488	3287	2859	2513	2249	1684	1335	1611	1586
Trading	240	226	163	150	144	168	203	181	221	174
	8922	7851	6884	5808	5294	5070	4392	3720	4633	5070

Source: As for Table D-2
DOE deflator

Table D-4: GROSS CAPITAL EXPENDITURE BREAKDOWN BY CLASS OF AUTHORITY
£million, England

Service	FY 1975	76	77	78	79	80	81	82	83
Met Counties:									
Rate Fund	114	120	124	130	140	128	174	173	185
Trading	5	7	5	5	8	19	27	35	44
	119	127	129	135	148	147	201	208	229
Met Districts:									
Rate Fund	443	402	362	308	342	461	458	410	640
HRA	333	390	416	406	419	508	447	322	406
Trading	24	27	11	12	14	17	44	37	55
	800	819	789	726	775	986	949	769	1101
London:									
Rate Fund	533	531	469	430	449	617	690	624	727
HRA	526	609	639	647	638	682	652	486	561
Trading	2	2	3	16	21	8	9	6	7
	1061	1142	1111	1093	1108	1307	1351	1116	1295
Non-Met Counties:									
Rate Fund	485	576	534	453	437	524	727	633	706
Trading	7	11	14	10	13	17	13	9	13
	492	587	548	463	450	541	740	642	719
Non-Met Districts:									
Rate Fund	591	490	448	406	487	545	541	509	739
HRA	657	787	799	711	710	741	642	615	758
Trading	63	69	59	50	45	83	117	104	110
	1311	1346	1306	1167	1242	1369	1300	1228	1607
All Authorities:									
Rate Fund	2166	2119	1937	1727	1855	2275	2590	2349	2997
HRA	1516	1786	1854	1764	1767	1931	1741	1423	1725
Trading	101	116	92	93	101	144	210	191	229
	3783	4021	3883	3584	3723	4350	4541	3963	4951

Sources: Local Government Financial Statistics. FY 75–83, FY 84 not available. Figures for FY 75 are based on Wales and England combined, adjusted by deducting FY 76 figures. Up to FY 80, figures are net of amounts not capitalised. To be consistent with later years these amounts have been apportioned pro rata to GRF services in each year.

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Table D-5: SHARE OF GROSS CAPITAL EXPENDITURE
England

FY	1976 %	1980 %	1983 %
Education	12	9	10
Health and Social Security	2	2	2
Law, Order and Protective	2	2	3
Transport and Highways	10	10	12
Non-HRA Housing	16	16	15
LES	10	13	18
HRA	45	45	35
Trading	3	3	5
	100	100	100
Met Counties	3	3	5
Met Districts	20	23	22
London	28	30	26
Non-Met Counties	15	12	15
Non-Met Districts	34	32	32
	100	100	100

Source: Audit Commission analysis of Local Government Financial Statistics (see Tables D-2, D-4).

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Appendix E

PROJECTIONS OF FUTURE CAPITAL SPENDING

Table E-1 below summarizes the study teams best estimate of future capital spending in England.

Table E-1: CAPITAL SPENDING
£million

	Gross Expenditure	Assumed Target	Variance
FY 1986	4,348	4,050	298
1987	4,415	4,050	365
1988	4,072	3,550	522
1989	3,628	3,050	578
1990	3,285	2,750	535
1991	2,993	2,550	443

Table E-2 provides the detailed breakdown; and the rest of this Appendix sets out the key assumptions involved.

Table E-2: PROJECTED CAPITAL EXPENDITURE PROGRAMME UNDER EXISTING CONTROL SYSTEM AMENDED FOR PROPOSED CHANGES FOR 1985/86

		£ Billion					
Line	Item	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
1	Cash limit	1.950	1.950	1.950	1.950	1.950	1.950
2	Capital receipts						
	a. In hand: – housing	3.000					
	– non-housing	2.000					
	Total brought forward	5.000	5.830	6.515	6.643	6.315	5.801
	b. New receipts – housing	1.600	1.800	1.300	.800	.600	.400
	c. New receipts – non-housing	.500	.300	.300	.300	.200	.200
		7.100	7.930	8.115	7.743	7.115	6.401
3	Capital receipt multiplier	.235	.230	.228	.227	.227	.228
4	Non-prescribed portion of receipts	1.630	1.650	1.250	.850	.620	.460
5	Gross allocations	3.580	3.600	3.200	2.800	2.570	2.410
6	Less: holdback etc.	.602	.600	.600	.600	.600	.600
	Net allocations	2.978	3.000	2.600	2.200	1.970	1.810
7	Supplementary allocation	.100	–	–	–	–	–
	Total allocations	3.078	3.000	2.600	2.200	1.970	1.810
8	Target	4.050	4.050	3.550	3.050	2.750	2.550
9	LA expenditure plan	5.000	5.000	5.000	5.000	5.000	5.000
10	Potential capital receipt spending	1.670	1.821	1.846	1.761	1.617	1.458
11	Less: LA holdback	.400	.406	.375	.334	.302	.275
		1.270	1.415	1.472	1.428	1.315	1.183
	Total allocations	3.078	3.000	2.600	2.200	1.970	1.810
12	Gross expenditure	4.348	4.415	4.072	3.628	3.285	2.993
13	Excess over target	.298	.365	.522	.578	.535	.443
14	Shortfall of LA plan	.652	.585	.928	1.372	1.715	2.007

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KEY ASSUMPTIONS

Line 1: Cash limit. Announced by Secretary of State for the Environment. December 18 1984. It is assumed for the purposes of this exercise that it will not be increased.

Line 2:

a. Capital receipts in hand. Department of the Environment's estimates announced by Secretary of State. 18 December 1984. The study team's own estimate of this figure had been constructed as follows.

		£billion
Estimate of unapplied capital receipts held at 1.4.81		1.0
Receipts 1.4.81 to 31.3.85		7.8
		8.8
Less: capital expenditure	19.0	
Less allocations	15.3	3.7
		5.1

An apportionment between housing and non-housing has been made based on available estimates.

Line 2: b. and c. (new receipts) estimated as follows:

	Housing £bn	Mortgages £bn	Other £bn	Total £bn
FY 1986	1.4	.2	.5	2.1
1987	1.1	.7	.3	2.1
1988	.7	.6	.3	1.6
1989	.5	.3	.3	1.1
1990	.3	.3	.2	.8
1991	.2	.2	.2	.6

Housing receipts are expected to decline sharply after FY 87 as the local authorities are left with the poorer tenants and the less attractive properties. The protections assume that an attractive acceptable scheme for the sale of mortgages can be developed in 1985–86 and will gain momentum in the two following years, and that local authorities will be under strong pressure to sell. Although 'other' receipts are currently running at a higher level than shown this is unlikely to be sustained. A declining amount has therefore been included.

Line 3: The capital receipt multiplier has been calculated for 1985–86 by multiplying the amounts by the relevant prescribed percentages (i.e. housing 20%, non-housing 30%). Thereafter it is impossible to estimate in what proportions authorities will apply their receipts. So the 1985–86 figure has only been adjusted for the estimated relevant proportions of new receipts. This approximation is not significant.

Line 4: Non-prescribed proportion of receipts has been calculated each year by multiplying the amount of new receipts by 80% or 70% as appropriate.

		£bn
e.g. FY 86 housing	1600 × 80%	1.280
other	500 × 70%	350
		1.630

Line 5: Gross allocation. Cash limit plus non-prescribed proportion of new receipts. It is assumed the non-prescribed proportion, not being able to justify new expenditure, is used to repay debt or invested and therefore netts down new borrowing in line with the cash limit.

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Line 6: Holdback. A new feature proposed for FY 86 to take account of flexibilities within the capital controls system and for a reserve for supplementary allocations for authorities complying with the call for capital expenditure restraint in FY 85. This adjustment is to allow for the right of local authorities to spend the prescribed portion of accumulated receipts. The figure is assumed to remain constant throughout the period.

Line 7: Supplementary allocation. An additional 5% of basic allocations for authorities complying with the request for voluntary restraint. The Secretary of State has assumed this will add £100 million to allocations for FY 86. It is assumed that this will be for one year only.

Line 8: Target. Cash limit plus estimated amount of capital receipts arising in the current year.

	£bn
e.g. FY 86 cash limit	1.950
new receipts	2.100
	4.050

The Secretary of State has announced that there will be no corrective action for spending 5% above the cash limit in 1985–86 i.e. £98 million.

Line 9: Local authority expenditure plan. It is assumed that local authorities will wish to maintain gross expenditure, excluding non-prescribed expenditure at a minimum level of £5 billion. This is based on past performance.

	Outturn	FY 86 Prices
FY 1982	£4.750bn	5.5
1983	5.547	6.1
1984	5.0 to 5.5	5.2 to 5.7

Line 10: Potential capital receipts spending. Capital receipts held at the beginning of the year plus receipts arising during the year multiplied by the capital receipt multiplier.
e.g. £7.1bn × .235 = £1.67bn

Line 11: Local authority holdback. It is unreasonable to believe that all local authorities would maximise their spending because:
- some spending power is not backed by cash, since it has been used to repay debt or is otherwise notional;
- some local authorities are relying on the interest from invested receipts in order to ease revenue expenditure problems;
- some local authorities do not need to maximise spending to meet their needs; and many authorities wish to spread resources over a long period.

An arbitrary reduction of £400 million has been made for these combined factors.

Line 12: Local authority spending. The likely level of expenditure, being the aggregate of allocations plus the likely use of capital receipts.

Line 13: Excess over target. The difference between the likely level of local authority spending and the target i.e. line 12 minus line 8.

Line 14: Shortfall of expenditure. The difference between the amount it is assumed local authorities would wish to spend and the level they will be permitted to spend i.e. line 9 minus line 12.

Non-prescribed expenditure, inflation and tolerance have been ignored. With the continued threat of 'overspending' it is possible that the tolerance regulation will be amended so that one year is balanced with another and does not become an additional allocation.

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